MINISTRY OF FINANCE

3.07–Community Reinvestment Fund

BACKGROUND

In 1996, the Government of Ontario embarked on a review of provincial-municipal service delivery arrangements that became known as “Who Does What.” This initiative sought to identify opportunities for providing greater accountability to taxpayers, lowering costs, improving local autonomy, and reducing duplication and waste. The initiative led to the *Services Improvement Act*, under which certain provincial and local responsibilities were realigned. The realignments were intended to bring education costs under control, provide better service for taxpayers, and ease the pressure on residential property taxes. The initiative became known as Local Services Realignment, or LSR.

LSR was implemented in Ontario effective January 1, 1998. It involved the realignment of responsibilities and costs relating to 16 programs. Some programs previously administered by the province have been fully transferred and are now being funded and administered exclusively at the local level. Other programs have been transferred but are being cost shared between the province and the municipalities. For these programs, the province continues to be responsible for between 50% and 80% of program costs. Still other programs continue to be fully administered by the province. For these programs, the province bills the municipalities to recover the program costs it has incurred for the services delivered on their behalf.

The following table summarizes the details of the LSR programs and costs transferred.

LSR Programs

LSR Program and Transfer Status as of January 1, 2001	Ministry	Eligible Costs, 2000 ($ millions)
Fully Transferred Programs		
Municipal Support Grants[1]	Municipal Affairs and Housing	665
Municipal Transit	Transportation	275
Public Housing	Municipal Affairs and Housing	143
Property Assessment	Finance	129
GO Transit	Transportation	79
Farm Tax Rebate	Agriculture, Food and Rural Affairs	58
Other	Various	110
Provincial Offences Revenues[2]	Solicitor General	(67)
Children's Aid Societies[3]	Community and Social Services	(78)
	SUBTOTAL	**1,314**
Programs Transferred and Cost-Shared		
Social Assistance • Sole Support Parents	Community and Social Services	215
Land Ambulance	Health and Long-Term Care	111
Child Care	Community and Social Services	63
	SUBTOTAL	**388**
Provincially Administered Programs Billed to Municipalities		
Non-profit, Co-op, and Private Rent Geared to Income Housing	Municipal Affairs and Housing	591
Social Assistance • Ontario Disability Support Program and other social support programs	Community and Social Services	570
Policing	Solicitor General	77
Public Health	Health and Long-Term Care	75
	SUBTOTAL	**1,313**
	TOTAL ELIGIBLE LSR COSTS	**3,015**

1 Since these provincial grants were discontinued as part of LSR, they have been treated as eligible municipal "costs" as part of the transfer arrangements. The cost of actual LSR programs fully transferred to the local level is therefore $1,314 million less $665 million or $649 million.

2 Revenues transferred to municipalities.

3 A municipal responsibility prior to LSR, now a provincial responsibility.

Source of data: Ministry of Finance

As can be seen from the table, the LSR initiative transferred a wide range of programs. This transfer of funding responsibilities from the provincial to the municipal level has been identified as a trend throughout Canada in a C.D. Howe Institute publication entitled "Municipal Finance in a New Fiscal Environment," issued in November 2000. The study notes that one result of this transfer is that municipalities must increasingly rely on own-source revenues. Accordingly, programs once funded from a broad provincial spending base are now funded from a much narrower municipal property-tax spending base. The study further points out that, between 1988 and 1998, Ontario transferred more responsibilities to municipalities than any other jurisdiction. The prime example it cites is social services. In Ontario, social services now account for 25% of municipal expenditures. In municipalities outside of Ontario, such costs account for only 1.2% of municipal expenditures.

To help enable municipalities pay for the $3 billion cost of the transferred LSR programs, the province assumed responsibility for 50% of the educational portion of residential property taxes. The province thus took over funding of approximately $2.5 billion in education costs that previously had been paid by the municipalities out of these property taxes collected. This created what is referred to as “tax room” for municipalities. By raising essentially the same total amounts in local taxes as before, municipalities would have an additional $2.5 billion to fund the transferred LSR programs.

The province further facilitated the introduction of the LSR program transfers through a number of specific one-time transitional payments totalling over $1 billion. In addition to this transitional funding, the Community Reinvestment Fund (CRF) was established in 1998 to provide annual payments. The key objective of the CRF is to ensure that the LSR initiative was and remains revenue neutral by annually making up the difference between net LSR costs transferred and municipal tax room.

While the revenue neutrality objective is not set out in legislation, the then-Minister of Municipal Affairs and Housing, in discussing the CRF in the Legislature, stated on October 8, 1997 that “we’ll be able to distribute the Community Reinvestment Fund so that every municipality will come out revenue neutral.” Thus, revenue neutrality is to be achieved annually, not only between the government and municipalities as a whole, but also between the government and each individual municipality. The Minister of Finance reaffirmed this objective of revenue neutrality for each municipality in correspondence with municipal Heads of Council in 1998 when the program was introduced.

A payment formula is used to calculate CRF entitlements. Payments are issued quarterly. Since 1998, CRF payments to eligible municipalities have totalled approximately $1.8 billion, with $500 million being paid in the 2000/01 fiscal year.

The CRF has been further supplemented with a CRF Bonus (introduced in 1999) and Supplementary Assistance (introduced in 2000).

The Ministry recognizes that the current structure of the CRF demands a high level of accounting and administrative effort. It also recognizes that, with its current focus on LSR costs and residential education tax room, the current CRF does not address the full range of municipal expenditure needs and fiscal capacity. As a result, at the time our audit commenced, the Ministry had initiated a review of the CRF program, and a range of options was being considered for providing financial support to municipalities in future. Therefore, the year 2001 was being treated as a transitional year pending potential program changes resulting from the review.

AUDIT OBJECTIVES AND SCOPE

The objectives of our audit were to assess the extent to which:

- adequate procedures existed to measure and report on whether the CRF was meeting its objective of ensuring that the LSR initiative was revenue neutral; and
- CRF system controls and related procedures were adequate to ensure that municipal payments were properly authorized and accurately processed.

Our audit was performed in accordance with the standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

Prior to the commencement of our audit, we identified audit criteria that would be used to address our audit objectives. These were reviewed and accepted by senior Ministry of Finance officials. The scope of our audit included interviews and an examination and analysis of relevant documents and administrative procedures. Audit work was conducted at the Ministry of Finance and at a number of ministries responsible for LSR programs. We also met and corresponded with representatives from the Association of Municipalities of Ontario.

Our audit work covered the period to March 31, 2001. Because LSR ministries were still in the process of finalizing data for the 2000 calendar year at the time of our audit, much of our analysis and testing was conducted on data for the 1999 calendar year. Since the Ministry of Finance's internal audit had not conducted any work in this area, it did not affect our work.

OVERALL AUDIT CONCLUSIONS

With respect to revenue neutrality, we concluded that the Ministry did not have adequate procedures to measure and report on whether the CRF was meeting this objective. In addition, certain evidence indicated that the CRF did not ensure the ongoing revenue neutrality of the LSR initiative, either as a whole or for individual municipalities, and that this problem had been growing over time. The divergence from revenue neutrality was in both directions. Some municipalities have clearly gained financially from the LSR trades, while other municipalities have lost. We also noted areas where the impact of the funding process on individual municipalities needs to be assessed.

Based on the following observations, we believe the CRF as structured at the time of our audit was working against its objective of ensuring the revenue neutrality of the LSR initiative. Further, it has led to differing impacts on individual municipalities.

- For programs fully transferred to municipalities, LSR costs for CRF entitlement purposes were frozen at the amounts existing at the time of program transfer. As a result, the actual costs incurred by municipalities in subsequently delivering these programs were not being taken into account in determining each municipality's CRF entitlement.
- For cost-shared and provincially administered programs, LSR costs for CRF entitlement purposes were frozen at the year 2000 amounts, rather than being set at the expected actual levels for 2001. Unlike in past years, with the exception of the Land Ambulance program,

there will be no year-end reconciliation and additional payments to reflect actual LSR costs exceeding those expected.

- The CRF allocation formula takes into account only those LSR costs that remained after the deduction of approximately $500 million annually to reflect a provincially imposed savings target. That target is a percentage of total municipal spending. The imposed savings target varies by size of municipality, and the Ministry has little empirical or analytical support for this approach. Furthermore, since $1.3 billion in LSR programs are still administered by the province, the savings target presents municipalities with the challenge of finding savings in programs they do not control.
- Because of the intricacies of the CRF funding formula, the savings target has had no effect in some municipalities. Such municipalities experienced annual windfall gains from the LSR initiative without having to find any local savings, while other municipalities experienced a significant, negative fiscal impact.
- The Ministry did not update the residential-education tax-room component of the CRF payment formula to reflect recent changes in assessment data, including changes in the latest province-wide current value assessment (CVA). Property assessments increased by an average of 14% above those used for CRF purposes. Updating the tax room component to reflect these changes would have increased the CRF entitlement of some municipalities and decreased the entitlement of others.

Because of the interconnectedness of the components of the CRF funding mechanism, we made a single recommendation to deal with the above concerns.

With respect to program administration, we concluded that overall system controls and procedures were adequate to ensure that CRF payments were properly authorized and processed. However, we did note areas where procedures could be strengthened. Specifically, we recommended that the Ministry:

- improve its monitoring and follow-up efforts with municipalities to ensure that CRF funds are used by municipalities as directed;
- implement procedures to recover or minimize CRF overpayments, which have amounted to $98 million over the three-year period from 1998 to 2000; and
- improve the timeliness of providing CRF information to municipalities to enable municipalities to better estimate their budgetary requirements and report on their fiscal results.

DETAILED AUDIT OBSERVATIONS

REVENUE NEUTRALITY

The objective of the CRF is to ensure that the LSR initiative is and remains revenue neutral. An LSR funding formula has been established to achieve this objective. It is summarized as follows:

$$\begin{matrix}\textbf{LSR}\\\textbf{Program}\\\textbf{Costs}\end{matrix} - \begin{matrix}\textbf{Municipal}\\\textbf{Savings}\\\textbf{Targets}\end{matrix} - \begin{matrix}\textbf{Residential}\\\textbf{Education}\\\textbf{Tax Room}\end{matrix} - \begin{matrix}\textbf{CRF}\\\textbf{Entitlements}\end{matrix} \leq 0$$

We noted that ensuring municipal equity is not an objective of the CRF or the LSR funding formula.

The Ministry has not established formal performance indicators that would measure the extent to which the application of this formula is actually achieving its revenue neutrality objective. Based on our audit work on each of the formula's components, we believe such performance indicators are needed. Our audit work on these components indicated that the manner in which each of them is applied impairs the achievement of revenue neutrality. This section deals with each component of the formula and ends with a single recommendation that deals collectively with our concerns.

LSR Costs

FULLY TRANSFERRED PROGRAMS

At the time of our audit, LSR programs costing approximately $650 million annually had been fully transferred to and were being administered by municipalities. For purposes of eligibility for CRF entitlements, such costs were frozen at the point in time when the program was transferred.

Freezing CRF-eligible costs at the time of program transfer does not take into account actual costs incurred by municipalities in delivering these programs subsequent to the transfer. Costs change for many reasons, such as changes in local demographic structure, the requirement to raise program performance to meet provincial standards, the introduction of expenses unique to the municipal level such as provincial sales tax and Workplace Safety Insurance Board charges, wage increases, rising fuel prices (for Municipal and GO Transit), and general economic fluctuations.

For example, GO Transit, which at current fare rates requires significant government subsidization, was fully transferred to the municipalities as of August 1999. GO Transit expects ridership to increase by 18 million, or 3.7% annually, over the next 10 years, which will have an impact on ongoing operating costs. In addition, it expects to incur some $1 billion in capital costs over the same period.

Since there are no adjustment mechanisms to take into account changing local costs of fully transferred programs, the Ministry has no assurance that the CRF funding provided is achieving revenue neutrality on an ongoing basis. This problem will become larger as more programs are fully transferred. The Association of Municipalities of Ontario (AMO) expressed this same concern in their correspondence to us, noting that the CRF does not recognize changes in local service delivery needs.

Changes in the costs of social programs emerged as a particular concern in our discussions with the AMO. Social programs often experience significant cost fluctuations as the economy moves through upturns and downturns. The AMO has expressed the viewpoint that municipalities are not ideally equipped to deal with such volatility, as they lack the revenue sources open to the province, are restricted in their ability to borrow, and cannot incur deficits.

COST-SHARED AND PROVINCIALLY ADMINISTERED PROGRAMS

As of January 1, 2001, nearly $400 million in the costs of programs that had been fully transferred and put under the management of municipalities was still being shared between the province and the municipalities. The remaining LSR programs continued to be fully administered by the province. Municipalities are billed for these program costs, which amount to approximately $1.3 billion.

Until 2001, both the cost-shared and provincially administered programs had been funded on the basis of actual costs incurred. Specifically, for 1998, 1999, and 2000, the actual costs of these programs were compared to the funding advanced based on forecasted costs. Municipalities were given additional funding to make up any shortfall between forecasted and actual costs. Over the past three years, a total of $60 million in additional funding was provided to municipalities as a result of these year-end reconciliations.

However, because the CRF program was under review at the time of our audit, 2001 is being treated as a transitional year. In contrast to the procedures for 1998–2000, except for Land Ambulance program costs, there will be no year-end adjustments to reflect the difference between forecasted and final actual costs. We believe this approach compromises the revenue neutrality of the LSR initiative for cost-shared and provincially administered programs for the year 2001.

At the time of our audit, the Ministry had not determined whether or not updated costs will be incorporated into the CRF formula in future years. We believe it to be essential that a payment formula intended to achieve revenue neutrality use actual costs incurred. This is particularly important for:

- social assistance programs, which, similar to the fully transferred Public Housing program, could face significant financial pressures if the Ontario economy weakens; and
- programs for which municipalities are expected to achieve performance standards that the province had been unable to meet when it administered the programs. For example, as we discussed in our Special Report to the Legislative Assembly in 2000, the province had difficulties in meeting its response-time requirements for the Land Ambulance program.

Savings Targets

As part of the formula to achieve revenue neutrality, the province has imposed an annual savings target of approximately $500 million on municipalities' total expenditures. The amount of savings on total expenditures required of individual municipalities varies according to the size of the municipality as follows:

- 4.2% for municipalities with a population greater than 500,000;
- 3.2% for municipalities with populations between 100,000 and 500,000; and
- 1.7% for municipalities with populations of less than 100,000.

The savings requirement is deducted from LSR costs for the purpose of determining the CRF entitlement for each municipality. Over the last three years the imposed municipal savings have totalled $1.5 billion.

We are concerned that the required savings percentages varied according to municipal size. We found the rationale for this procedure not to be based on a thorough analysis. The Ministry's rationale was that larger municipalities have more opportunities to achieve "economies of scale" than smaller municipalities do. We would have expected this rationale to be supported by empirical or analytical evidence that would provide assurance that such savings targets were achievable and that they would be appropriate for all municipal programs. Varying savings targets based on population may also penalize some municipalities that have already been managing operations cost efficiently.

Furthermore, as the earlier chart indicates, there was $1.3 billion in LSR programs still being administered by the province. Municipalities cannot realize any savings on programs that they themselves do not administer.

Finally, we are also concerned with the impact of the savings targets on revenue neutrality. For example:

- In one municipality, available residential education tax revenue, or tax room, has exceeded transferred LSR costs by $45 million over the past three years. The $45 million represents a windfall gain for the municipality as it was not needed to fund LSR program costs. The municipality has not had to realize any savings as a result of LSR.
- In another municipality, total LSR costs over the last three years have been approximately $1.835 billion. This municipality's tax room for the three years has been $1.695 billion. Without the imposed savings target, the municipality would have received payments from the CRF of about $140 million.

  However, the total savings target imposed on the municipality over the three-year period has been $561 million, or 31% of its LSR costs, resulting in net eligible LSR costs of $1.274 billion. Since $1.695 billion in tax room exceeds the net eligible LSR costs of $1.274 billion, this municipality has been ineligible for any CRF support. We noted that the government claimed in a media release dated December 28, 2000 that this municipality had benefited from the LSR service trades by "more than $100 million in 1998, more than $150 million in 1999, and more than $150 million estimated for 2000." In this media release the government assumed that the municipality achieved all the target savings imposed by the province. However, the province had no evidence that these savings targets had actually been achieved.

The following chart summarizes the two scenarios discussed and includes, for the sake of completeness, a third scenario. In this third scenario, the municipality is entitled to CRF funds.

Cumulative CRF Entitlements of Selected Municipalities, 1998–2000

	Municipality Type A	Municipality Type B	Municipality Type C
	Savings target has no impact as tax room exceeds LSR costs	Savings target reduces eligibility to zero	LSR costs exceed tax room after savings target
	Not CRF eligible	Not CRF eligible	CRF eligible
	($ millions)	($ millions)	($ millions)
total eligible LSR costs	465	1,835	82
tax room	– 510	–1,695	– 51
program transfer (gain)/loss	(45)	140	31
savings target	not applicable	– 561	– 4
CRF entitlement	nil	nil	27

Source of data: Ministry of Finance

VFM Section 3.07

As the chart illustrates, the mechanics of the funding formula require municipalities of Types B and C to either find savings locally or fund a portion of LSR program costs from local revenues. In contrast, for municipalities of Type A, not only are all LSR costs funded, but additional funds are available to subsidize other municipal expenditure areas. We noted that for the 1999 calendar year 72 municipalities fell into the Type A category; that is, they had tax room greater than the cost of the LSR programs transferred. The "windfall gains" of these municipalities for that year totalled approximately $134 million.

In summary, we believe that imposing a savings target on all municipal spending essentially conflicts with the LSR revenue neutrality objective. Therefore, incorporating the savings target based on population size into a funding formula designed to achieve revenue neutrality has led to conflicting conclusions about the success of the revenue neutrality aspect of the LSR initiative. Moreover, the mechanics of the current CRF formula create an unequal imposition of the savings targets across the province. Many jurisdictions escape from the need to find any savings at all simply because their tax room exceeds their transferred LSR costs.

Given our concerns about both the determination of the savings target and the LSR cost components of the CRF formula, we believe the Ministry needs to implement performance indicators that objectively measure the extent to which the various components of the formula facilitate the revenue neutrality intent of LSR.

Tax Room

Effective with the 1998 implementation of LSR, the province began to fund directly those education costs previously paid for by 50% of residential education taxes. This created local "tax room." In essence, assuming there was no change in local taxes levied, municipalities had additional revenues of approximately $2.5 billion to fund the costs of the transferred LSR programs.

Under the CRF formula, the basis for allocating the tax room to each municipality is the current value assessment (CVA) on which the municipalities base their property taxes. A province-wide CVA of Ontario properties is conducted every three years. Less extensive CVA adjustments are made annually. For 1998, the Ministry used the 1996 province-wide CVA results to calculate tax-room allocations. For 1999, the 1998 tax-room allocations were updated to include any in-year changes to the CVAs. This update resulted in an increase in total tax-room allocations of $40 million between 1998 and 1999. However, for the purpose of the 2000 CRF, the 1999 tax-room allocations were used without being updated by in-year CVA changes.

In 2001, the 1999 province-wide assessment results were available. Overall, CVAs across the province had increased by a total of 14% over 1996. However, for 2001 the Ministry once again used the 1999 tax-room allocations without adjustment, reflecting neither the normal in-year changes nor the 1999 CVA. If the updated 1999 property values had been used, individual municipalities' tax rooms may have been significantly different, as follows:

- In municipalities in which CVAs had dropped, the drops would have worked to increase CRF entitlements. We found that CVAs dropped in 109 municipalities, with drops ranging from 0.03% to 15%.
- In municipalities in which CVAs had risen, the increases would have worked to reduce CRF entitlements. We found that CVAs increased in 350 municipalities, with increases ranging from 0.2% to 50.1%.

Not to reflect changes in property value assessments impedes the accurate calculation of the tax room available to each municipality and thus also impedes the achievement of revenue neutrality.

CRF Review

At the time of our audit, the Ministry was considering a range of policy options for structuring future municipal financial assistance. As a result, the CRF was under review. We are encouraged by the Ministry undertaking this review initiative, as we believe it is warranted.

The review provides an opportunity for the Ministry of Finance to continue to work with the Ministry of Municipal Affairs and Housing (MMAH) in developing its future municipal support initiatives. In this regard, we note that the MMAH has recently launched a Municipal Performance Measurement Program. This program requires municipalities to report annually on the efficiency and effectiveness of local service delivery in nine core areas. These core areas include its LSR program responsibilities for transportation, police, and social services.

Recommendation

To ensure that future municipal financial support continues to meet the government's overall municipal support objectives, the Ministry should work with the Ministry of Municipal Affairs and Housing and incorporate in its approach an assessment of:

- **changes in local service delivery needs; and**
- **current municipal taxing capacity.**

If, as a result of the Community Reinvestment Fund (CRF) review, the Ministry decides to continue with the CRF approach to municipal funding, it should develop performance indicators to measure its achievement of revenue neutrality on an ongoing basis. To be able to assess the achievement of the objective of revenue neutrality and issues of divergent impacts of the CRF formula, the Ministry should ensure that its review considers:

- **the extent to which the CRF reflects actual Local Services Realignment costs incurred;**
- **the reconciliation of forecasted costs to actual costs at each year-end and subsequent payment adjustments;**
- **the distribution of any required savings efficiencies across the province based on analysis and empirical information; and**
- **the implications of up-to-date current value assessment data in its determination of municipal tax room.**

Ministry Response

At the time the Provincial Auditor's Office commenced its audit of the CRF, the Ministry was already conducting a review of the program that is now close to completion. The first part of the recommendation is consistent with the government's objectives for that review. The Ministry agrees with the second part of the recommendation, concerning continuing with the CRF approach, and will consider it in the review of the CRF.

CRF BONUS AND SUPPLEMENTARY ASSISTANCE

The total CRF funding package in the 2000/01 fiscal year was $561 million. This amount included CRF payments of about $500 million, a CRF Bonus of $21 million, and Supplementary Assistance of $40 million. The CRF Bonus was established in 1999 after the introduction of certain cost-sharing initiatives. The stated objective in providing the Bonus was to ensure that all municipal taxpayers benefited from the province's decision to fund 50% of LSR costs for the Land Ambulance and Public Health programs. Supplementary Assistance was introduced in 2000 to give additional support to municipalities with lower taxing capacities.

In an analysis of municipalities that received the CRF Bonus and/or Supplementary Assistance in 2000, we noted that a total of $7.7 million of these funds had been paid to 34 municipalities whose tax room exceeded their LSR costs. As discussed earlier, these "Type A" municipalities were already benefiting from windfall gains, and these payments increased these windfalls.

To date, the documentation provided by the Ministry does not clearly support the need for either the Bonus or Supplementary Assistance.

Recommendation

The Ministry should conduct regular reviews of the bonus and supplementary-assistance components of the Community Reinvestment Fund to ensure that they are achieving the government's objectives.

Ministry Response

The Ministry agrees with the audit recommendation and will conduct such regular reviews.

PROGRAM ADMINISTRATION

LSR Program Costing Systems

As described previously, the CRF entitlements of provincially administered LSR programs in 2000 were based on actual 1999 year-end costs, with a reconciliation and payment adjustment process after year-end to reflect actual 2000 costs. For four of the largest LSR programs, we reviewed the systems and procedures used to calculate these costs.

Generally, we found that the systems and procedures for compiling the LSR costs were working well and resulted in reliable cost information. Our findings were consistent with other audit work done on these costing systems. In 1999, a consulting firm reported that the systems and procedures used to generate social housing billing amounts were suitably designed to provide reasonable assurance that the Ministry of Municipal Affairs and Housing and the Ontario Housing Corporation social housing billings were accurate and complete. The Internal Audit Division of the Ministry of Community and Social Services also recently completed an audit of the Ministry's LSR municipal billing process. It concluded that financial systems for generating and allocating cost data were effective.

Monitoring of Municipalities

Until 2000, CRF funding was provided unconditionally to municipalities. However, in March 2000 the government announced a number of new CRF-related reporting requirements. The information required from a municipality included data on local tax rates, as well as reports on how the municipality had used and planned to use its CRF funding. Furthermore, municipalities could no longer allocate CRF funds to reserve funds for future use; instead, CRF funds would have to be used to decrease local taxes otherwise payable for the current tax year. If a municipality was found to be applying its CRF entitlement in a manner that did not benefit current year taxpayers, the province reserved the right to reallocate the CRF payment to municipalities deemed to be in greater need.

These requirements created new monitoring responsibilities for the Ministry. The Ministry responded to these new responsibilities by launching a new monitoring initiative in 2000. However, we found that this monitoring needed to be improved. While the Ministry did obtain assurances from municipal councils that CRF funding had not been allocated to reserve funds, we found the following:

- To obtain assurance that municipalities used CRF funding in the current year, the Ministry would have had to obtain information on and assess the cash and working capital balances of the municipalities to ensure they had not risen significantly. No such assessment had been made.
- A summary of the submitted tax-rate data indicated that 245 municipalities had increased tax rates between 1999 and 2000. The increases ranged from 0.1% to 49.4%, with an average increase of approximately 6%. Only 43 of these municipalities voluntarily provided information on the circumstances surrounding their tax-rate increases, and there has been no follow-up by the Ministry to obtain information on the reasons for the remaining increases. Rising tax rates could indicate that, rather than achieving their savings targets, municipalities recovered such amounts from local taxpayers.
- Only municipalities that received CRF funding were asked to provide information to the Ministry. However, as discussed earlier, many municipalities ineligible for CRF funding have not had to realize any savings and have experienced windfall gains as a result of LSR. To ensure that the government's objectives are achieved, we believe all municipalities should be monitored. Municipalities with windfall gains were not assessed to determine if such gains are being passed on to the local taxpayers.

According to the Association of Municipalities of Ontario, municipalities find some of the new conditions imposed on them to be problematic. Specifically, the requirement that CRF funds not be allocated to reserves has in their view had a negative impact on local autonomy and fiscal planning and management. Municipalities use reserve funds accumulated from one period to finance planned expenditures in a future period. Using reserves, municipalities can undertake major projects without significantly affecting local taxes for any one year. Given that legislation restricts the ability of municipalities to borrow or incur deficits, reserves become a particularly important fiscal planning tool.

Recommendation

If the Community Reinvestment Fund (CRF) continues in its current form, the Ministry should determine whether municipalities are adhering to program requirements by:

- **reviewing municipal cash and working capital balances to ensure CRF funds are being used as intended by the government;**
- **following up with all municipalities that reported tax increases between 1999 and 2000 to determine why the increases were necessary; and**
- **assessing whether municipalities with windfall gains have passed these benefits on to taxpayers.**

To ensure that municipal fiscal planning is not negatively impacted, the Ministry should also work with municipalities and the Ministry of Municipal Affairs and Housing to determine if and when it would be appropriate to allow the allocation of CRF funds to municipal reserve accounts.

Ministry Response

The Ministry acknowledges that the results of the first year of CRF reporting demonstrate the need to strengthen existing procedures to monitor and assess whether municipalities are using the CRF grant in accordance with provincial objectives. At the same time, the Ministry recognizes municipal concerns that a balance must be established to ensure that changes in procedures respect municipal autonomy and do not restrict municipal budgetary decisions. With respect to allowing the allocation of CRF funds to municipal reserve accounts, the Ministry agrees with the audit recommendation and will continue in its partnership with the Ministry of Municipal Affairs and Housing to address this issue for 2002.

Overpayments

As mentioned previously, with the exception of fully transferred programs, year-end reconciliations have been performed to compare forecasted LSR costs with actual costs. The Ministry has provided additional funds to make up for shortfalls. However, in cases where year-end reconciliations identify actual costs as being below those forecasted, municipalities have been allowed to retain the excess funds provided. Unrecovered overpayments over the last three years have totalled $98 million.

We believe that, to give due regard to economy, recovery of overpayments needs to be considered. For instance, the recovery could be accomplished by reducing the first quarterly CRF payment for a subsequent year by the overpaid amount.

However, if the decision is made not to recover overpayments, the Ministry should develop a strategy to minimize their occurrence. Such a strategy could include adjusting downwards LSR program cost forecasts that, after analysis, can be identified as resulting in probable overpayments. Alternatively, the strategy could include holding back a portion of the projected CRF entitlement until actual costs are known.

Recommendation

To ensure that Community Reinvestment Fund (CRF) payments are appropriately made with due regard for economy, the Ministry, in its review, should consider the recovery of CRF overpayments or develop a strategy to minimize their occurrence.

Ministry Response

The Ministry will assess changes to its existing administrative procedures to minimize unplanned overpayments. The Ministry will need to consider municipal capacity and impact when implementing any changes in these procedures for 2002.

Municipal Information Requirements

Municipalities' budgets and financial statements are prepared on a calendar-year basis. The budget cycle for the upcoming year typically starts in late summer or early fall. In late fall through winter, the municipal budget is distributed to the local council for review and approval. Provincial financial support is a key component of municipal budgets. Accordingly, timely information from the province as to what provincial funding will be provided significantly improves the municipal planning process. It allows decisions such as those regarding municipal tax rates to be made with greater confidence and precision.

To date, the Ministry has been unable to provide municipalities with information concerning their current year's CRF entitlement until late February or early March. By that time, most municipalities have had to set their municipal tax rates for the year. The final adjusted entitlement for the prior year is also not provided until the completion of the Ministry's year-end reconciliation process in early April. This timing makes it difficult for municipalities to estimate their budgetary requirements and impossible for them to accurately reflect provincial funding in their year-end financial statements. In our discussions with the Association of the Municipalities of Ontario, it was confirmed that this lack of timely information was a significant concern for many municipalities.

Recommendation

To improve municipalities' ability to accurately project provincial funding when they set municipal tax rates and to facilitate the accurate reporting of such funding in municipal year-end financial statements, the Ministry should work to improve the timeliness of the information it provides to municipalities regarding Community Reinvestment Fund entitlements.

Ministry Response

The Ministry agrees with the recommendation and will work to address this issue for 2002.