

REPORTING AND DUE DILIGENCE FOR

THE CITY OF GREATER SUDBURY

SUGGESTED POLICIES AND PROCEDURES

Prepared for:

The City of Greater Sudbury
Tom Davies Square
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Submitted by:



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Private and Confidential

Mr. Doug Wuksinic
General Manager of Corporate Services
The City of Greater Sudbury
Tom Davies Square
200 Brady Street
Sudbury, Ontario P3E 5P3

October 31, 2001

Dear Mr. Wuksinic

As requested, KPMG is very pleased to provide our recommendations concerning financial reporting and due diligence procedures for the City of Greater Sudbury (the "City"). We appreciate the opportunity to be of continued service to the City and hope that our report will assist Council and senior staff in their overall management of City matters.

As outlined to us, we understand that the purpose of our recommendations are two-fold:


- To provide sufficient information to Council to allow them to understand and monitor the financial performance of organizations in which the City has a direct investment, such as Greater Sudbury Utilities Inc.
- To allow City staff to conduct preliminary due diligence procedures on potential initiatives considered by the City.

We would like to emphasize that our comments concerning financial reporting and due diligence procedures are merely suggestions. As a result, we would encourage the City to revise our recommendations, where considered appropriate, to reflect special circumstances or changes in policy direction.

We trust our report is satisfactory for your purposes. Should you have any questions concerning our recommendations or any other matters, please do not hesitate to contact us at your convenience.

Yours very truly


James G. Corless, FCA


Oscar A. Poloni, CA, CBV



FINANCIAL REPORTING

In the current economic environment, it is very common to have a considerable degree of delegation of responsibility and authority in both profit and non-for-profit organizations. In the case of the City, residents, local businesses and funding agencies all have an interest in its operations but are not involved in the day-to-day management of its activities. As a result, these parties look to the elected members of City Council to ensure that the use of public funds is in the best interest of the community. Accomplishing this requires accurate and timely reporting to Council concerning the financial performance of the City and its various subsidiaries, boards and related organizations.

KEY ATTRIBUTES OF FINANCIAL INFORMATION

Theoretically speaking, financial information is most useful when it addresses the following attributes:

- The financial information must be presented in a manner that is understandable to the reader. If the financial information is too complex, it may either be interpreted incorrectly or not considered at all.
- The financial information must be relevant to the decision-making process. It must present information that is meaningful to the issue being considered by the user.
- The financial information must be available when required. If the financial information is not produced in a timely fashion, it cannot be considered in the decision-making process.
- The financial information must be reliable and provide a meaningful reflection of the operations and performance of the organization in question.
- The financial information should be consistent and comparable. Decision-making often involves comparisons of financial performance, either against other organizations or historical results. Accomplishing meaningful comparisons requires similar methods of preparing and presenting financial information.

We recognize that these attributes will, in certain instances, conflict with each other. For example, ensuring reliability and accuracy requires an examination and verification of the information presented. The time required to review the information presented impacts on its timeliness, as financial information is often presented “after the fact”.

FINANCIAL REPORTING

CURRENT FINANCIAL REPORTING FOR THE CITY

The requirements of the City to report financial information are specified in the Municipal Act. As noted below, the Act requires all municipalities to report financial information to both the Ministry of Municipal Affairs and Housing (the "Ministry") and the general public.

"82.1 The treasurer of every municipality shall in each year within the time frame prescribed by the Ministry make a return to the Ministry on forms provided by it of such information and statistics with respect to the financial affairs, accounts and transactions of the municipality as the Ministry may prescribe..."

83.1 The treasurer of every municipality in every year shall, within the time prescribed by the Ministry after receiving the annual financial statements of the municipality, cause to be published or to be mailed or delivered to each ratepayer,

(a) A copy of the statement of revenue and expenditure, statement of capital operations, the balance sheet, the notes to the financial statements, the auditor's report, and the tax rate information for the current and previous year as contained in the financial review; or

(b) A summary of the information referred to in clause (a) in such form as the Ministry may prescribe..."

Currently, municipalities are required to file financial information, including audited financial statements and financial information returns ("FIRS"), by April 30th, or four months following the end of the municipality's fiscal year. Due to difficulties encountered with the electronic filing of FIRS and other issues, the deadline for filing FIRS and financial statements relating to the 2000 fiscal year was extended to June 30th, 2001.

In addition to publishing financial information, the Municipal Act also allows City Council to publicly disclose information that may be of interest to taxpayers and residents.

"83.3 The council of a municipality may cause to be published in a newspaper having general circulation in the municipality or to be mailed or delivered to each ratepayer in the municipality such information concerning the activities of the municipality as, in the opinion of the council, would be of interest to the ratepayers..."



FINANCIAL REPORTING

The 2000 fiscal year represented the last reporting period for the predecessor municipalities of the City. These financial statements were prepared on a consolidated basis and include a number of local boards and business enterprises of the predecessor municipalities, the majority of which have separate audited financial statements.

Local boards and business enterprises included in 2000 financial statements

	Separate Statements	Region of Sudbury	City of Sudbury	Capreol	Nickel Centre	Onaping Falls	Rayside-Balfour	Walden	Valley East
Library Board*	Yes		✓	✓	✓	✓	✓	✓	✓
Transition Board*	No	✓							
Police Services Board*	No	✓							
Sudbury Regional Development Corporation*	Yes	✓							
Greater Sudbury Utilities Inc.*	Yes	✓							
Metro Centre Management Board*	Yes		✓						
Flour Mill Business Improvement Area*	Yes		✓						
Sudbury Airport Development Corporation*	Yes		✓						
Sudbury District Energy Corporation*	Yes		✓						
Anderson Farm Board of Management*	No							✓	
Cemetery Board*	No					✓		✓	

* Consolidated

*Not consolidated but financial statements include note disclosure of revenues, expenses, assets and liabilities.

FINANCIAL REPORTING

For illustrative purposes, we have compared the financial reporting requirements of the Municipal Act to two other Provincial acts governing the reporting of financing information:

- The Ontario Business Corporations Act
- The Business Corporations Act

THE ONTARIO BUSINESS CORPORATIONS ACT

The Ontario Business Corporation Act (the “OBCA”) requires all Provincially-incorporated corporations to provide audited financial statements to their shareholders:

- 21 days before the date of the annual meeting, if the corporation is a public company
- 10 days before the date of the annual meeting, if the corporation is a private company

While the OBCA generally requires financial statements to be audited, the act does provide corporations with opportunity to exempt themselves from annual audits if the following conditions are met:

- The corporation must not offer its shares to the general public;
- All shareholders (including voting and non-voting shareholders) must unanimously consent to the waiving of the audit requirement; and
- The corporation must have assets of less than \$2.5 million and annual revenues of less than \$5 million.

With respect to the City, we understand that Greater Sudbury Utilities Inc., its subsidiaries and the Sudbury District Energy Corporation have been incorporated under the OBCA and, as such, would need to comply with these requirements.

THE BUSINESS CORPORATIONS ACT

Unlike the OBCA, which deals primarily with for-profit organizations, the Corporations Act (the “CA”) applies to non-profit corporations without share capital (which would appear to include community development corporations established pursuant to section 112 of the Municipal Act). The CA requires the presentation of audited financial statements at the non-profit corporation’s annual meeting except where:

- All members consent, in writing, to exempt the corporation from audit; and
- The annual income of the corporation is less than \$10,000

FINANCIAL REPORTING

RECOMMENDED FINANCIAL REPORTING STRUCTURE

Based on our understanding of the City's operations, including its investment in various business enterprises and community development corporations, we would suggest the following policy with respect to financial reporting for these investments:

1. The City continue its current policy of requiring independent audits of all business enterprises in which the City is the shareholder, including:
 - Greater Sudbury Utilities Inc. and its subsidiary companies
 - Sudbury District Energy Corporation
2. The City continue its current policy of requiring independent audits for all community development corporations in which the City is a member.
3. The external audits of the various business enterprises and community development corporations should be completed prior to March 31st of each year. While the OBCA and the CA establish financial reporting timelines based on the date of the organization's annual meeting, the need to consolidate the financial results of the various investments into the City's financial statements requires that the annual audits to be completed by March 31st, regardless of when the annual meetings are scheduled.
4. The financial results of the business enterprises and community development corporations be communicated to Council and the general public at the same time as the consolidated financial statements for the City are presented.

DUE DILIGENCE

WHAT IS DUE DILIGENCE?

In 1995, *Business Week* magazine analyzed U.S. mergers and acquisitions for the first half of the 1990's and found that "their performance has fallen far short of their promise". The article identified *inadequate due diligence* as a key factor in the failure of these deals to live up to expectations. In many cases, the people behind these deals did not effectively *size up their risks* before proceeding.

While there appears to be no one clear definition of due diligence, it is generally considered to involve a systematic assessment of information designed to identify and contain risks associated with any transaction to an acceptable level. The objectives of due diligence are relatively straightforward:

- To ensure the accuracy of the information presented and its appropriateness for inclusion in the decision-making process
- To identify areas of potential risk and their impact on the organizations involved
- To ensure that the end result of the proposed investment will be consistent with the overall goals and objectives of the organization

In light of the role that the City plays in meeting the basic needs of residents and businesses in Greater Sudbury, it is often approached to participate, invest in or otherwise assume a leading role in a number of initiatives intended to benefit the community. In order to ensure that the investment decisions made are based on strong fundamentals, the City has requested suggestions concerning a potential due diligence process for municipal involvement in these projects.

RECOMMENDED DUE DILIGENCE PROCEDURES

We recognize that due diligence procedures, by their nature, are very extensive and often require a significant investment in terms of personnel and costs for external advisors. We also appreciate that the City has a responsibility to its taxpayers and residents to be as efficient as possible. In light of this, we would suggest that the City adopt a two-stage approach to due diligence, consisting of:

1. Preliminary due diligence procedures performed internally, designed to assess the basic merits of the initiative and whether further consideration is warranted; and
2. Based on the results of the preliminary review, more extensive due diligence procedures intended to fully investigate the proposed initiative, including the involvement of external advisors

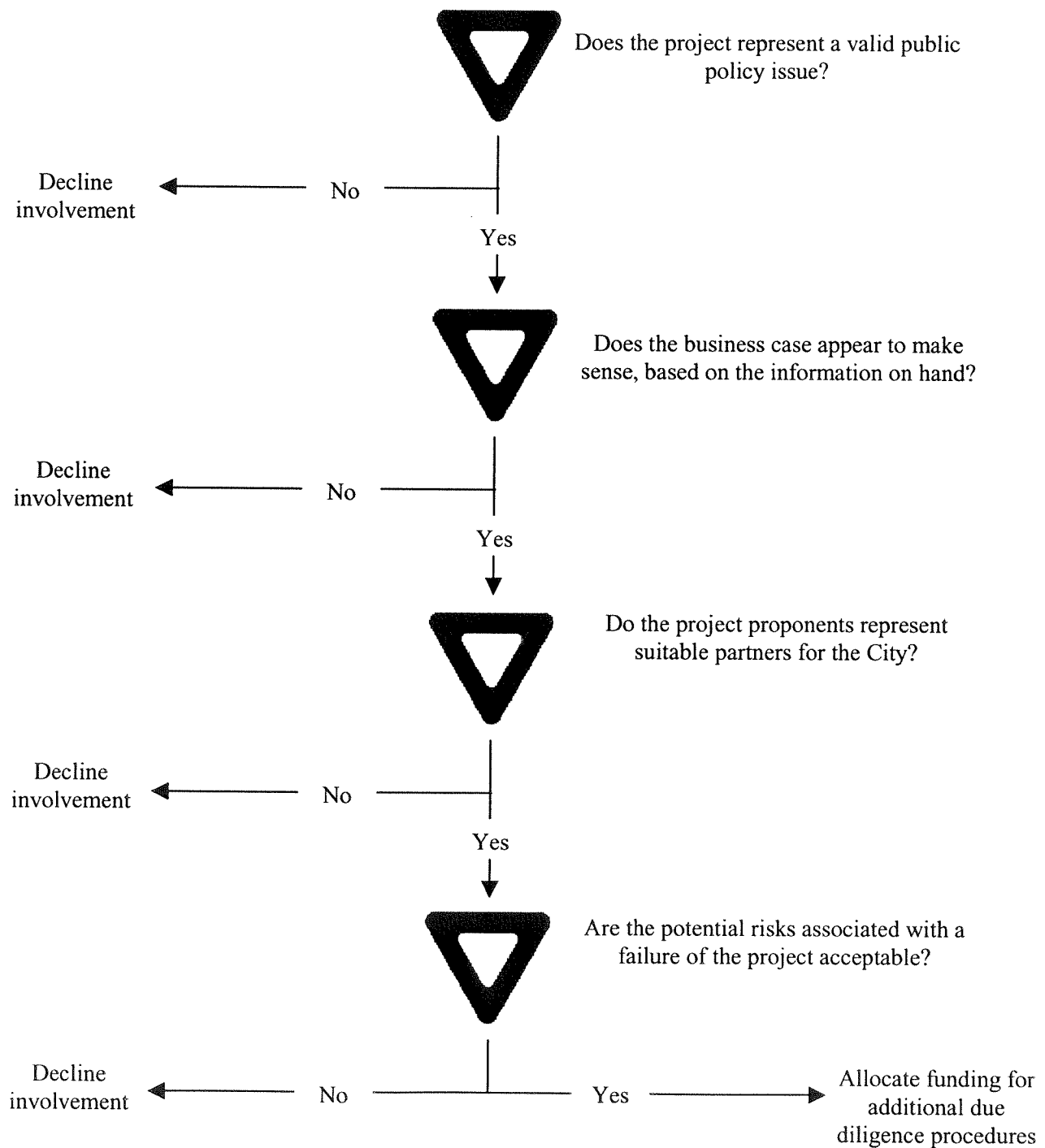
DUE DILIGENCE

We understand that the City of Greater Sudbury Community Development Corporation (the “GCSCDC”) has established a Community Economic Development Committee (the “Committee”), the intended role of which is to review and make recommendations concerning requests for assistance from the GCSCDC prior to their presentation to the Board of the GCSCDC. The Committee is comprised of members of the GCSCDC Board, including a representative of City Council, and staff resources from the GCSCDC.

Given the Committee’s intended mandate within the GCSCDC, the City may wish to consider using it to undertake the proposed preliminary review of initiatives. Alternatively, the City may wish to establish a similar committee, comprised of members of Council and City staff, to assess whether the City should invest funds for expanded due diligence procedures.

We have highlighted, on the following pages, a recommended process for conducting the preliminary due diligence review. In designing the process, we have attempted to address a number of qualitative and quantitative factors that should be considered when evaluating any initiative.

DUE DILIGENCE



DUE DILIGENCE

We have identified four key questions that should be answered by the City when evaluating the merits of any initiative and whether a further investment in due diligence is warranted. When answering these questions, we would suggest that the City consider the following:

1. Does the project represent a valid public policy issue?

- Is the project consistent with the City's overall mission of providing excellent access to quality municipal services and leadership in the social, environmental and economic development of the City of Greater Sudbury?
- Will the project contribute towards the City's vision of being a growing, world-class community bringing talent, technology and a greater northern lifestyle together?
- Do the goals of the project correspond with the City's goals of:
 - *Fostering economic development and job creation and embracing the digital revolution*
 - *Promoting the well-being of its citizens in a healthy, safe and stimulating community*
 - *Protecting and improving the environment and ecological health of the community*
 - *Developing a viable strategy to increase investment in infrastructure*
 - *Securing new sources of revenue through innovative strategies and partnerships*
 - *Presenting Greater Sudbury to the world as a dynamic and vibrant community*
- To what extent does the project focus on the City's key priorities of:
 - *Focusing on information and the communication technology sector*
 - *Ensuring citizens have access to health services in the community*
 - *Meeting the City's infrastructure needs for today and tomorrow*
 - *Adopting and implementing the principles of the healthy community movement*
- Do projects of this nature normally fall within the purview of the private sector?
- Are other community organizations, including those in the healthcare and education sectors, better suited to be involved in the project?
- Have other municipalities been approached to participate in similar projects and if so, what has been their experience?
- Will the City's involvement in the project comply with the conditions of application legislation and regulations, including the Municipal Act? *In light of the recent changes to the Municipal Act, we would suggest that the City's due diligence process be reviewed to ensure that its actions are both consistent with and take advantage of the revised Act.*

DUE DILIGENCE

2. *Does the business case appear to make sense, based on the information on hand?*

- Does the project make sense in light of economic and industry conditions? Has independent research been provided to support the proposal?
- Recognizing that valid public policy projects may require financial support from the City, what is the financial contribution of the municipality towards the project, both in terms of initial start-up costs and ongoing financing? How significant is this commitment compared to the available resources of the City?
- Are the costs involved in the project acceptable in light of the benefits to be obtained?
- Are the project proponents willing to accept some form of reporting mechanism to ensure that the City can monitor the results of its investments and the benefits to the community?
- To what extent will the City be required to contribute personnel or other non-financial resources to the project? Are sufficient non-financial resources currently available or will the project place a strain on the municipality?

3. *Do the project proponents represent suitable partners for the City?*

- Who are the proponents or advocates for the project? What is their position within the community?
- To what extent have the proponents been involved in other projects with the City? How successful have these projects been in achieving their intended results?
- Are the proponents in competition with other community groups or organizations for municipal support? If so, would it be more appropriate to undergo a request for proposal or similar comparative selection process?

4. *Are the potential risks associated with a failure of the project acceptable?*

- In the event of a failure of the project (representing the worse-case scenario), what is the risk of loss to the City as a result of:
 - Financial liabilities owing to lenders, creditors, employees and other parties;
 - Loss of reputation
 - Potential lawsuits from customers, suppliers and the project proponents themselves

DUE DILIGENCE

In instances where the Committee (or other body assigned to the due diligence process) considers that a project has met these preliminary questions, the City would then be in a position to undertake a more detailed investigation of the project, including, where considered necessary, the involvement of professional advisors. While the preliminary due diligence process involves a cursory review of non-financial issues (such as the congruence of the project with the City's mission and the background of the proponents) as well as financial aspects associated with the project, we would recommend that the more detailed due diligence process be focused on evaluating the potential costs, benefits and risks resulting from the project, including:

- Initial capital and start-up costs
- Sources of start-up funding, including municipal contributions
- Ongoing revenues and expenditures of the project, based on industry conditions and financial benchmarks with similar operations
- Sensitivity analysis to determine the impact that a small change in key assumptions will have on the overall financial performance of the project
- What are the legal, regulatory and legislative issues surrounding the project
- What is the likely exposure of the City to financial risk, either in the form of contributions to finance operations or in the event of a total failure of the project
- The extent to which the proponents are able to meet their commitments to the project, including management skills and financial resources available