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## MINISTRY OF FINANCE

### 4.07–Community Reinvestment Fund

(Follow-up to VFM Section 3.07, *2001 Annual Report*)

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#### BACKGROUND

Effective January 1, 1998, in an initiative that became known as Local Services Realignment (LSR), responsibilities relating to 16 government programs and some \$3 billion in program costs were realigned between the province and Ontario's municipalities. The programs included Municipal Transit, Public Housing, Social Assistance, Public Health, Policing, and Land Ambulance services. To help municipalities pay for the programs transferred to them, the province took over funding of approximately \$2.5 billion in education costs that previously had been funded by municipalities from local property taxes. As the municipalities were allowed to retain all local property taxes collected, this created what is referred to as "tax room" for municipalities.

The Community Reinvestment Fund (CRF) was established in 1998 with the objective of ensuring that the LSR initiative was and remains revenue neutral to municipalities by annually providing payments making up the difference between net LSR costs transferred and municipal tax room. Since 1998, CRF payments to eligible municipalities have totalled approximately \$3.1 billion, with \$623 million being paid in the 2002/03 fiscal year. In the 2000/01 fiscal year, \$561 million, which included the CRF Bonus and Supplementary Assistance, was paid.

In our *2001 Annual Report*, we concluded that the Ministry did not have adequate procedures to measure and report on whether the CRF was meeting its revenue neutrality objective. In addition, we found 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, with some municipalities clearly gaining from the LSR and others losing. We concluded that the CRF as structured at the time of our audit was working against the objective of ensuring revenue neutrality. Specifically:

- Eligible LSR costs for fully transferred programs were frozen at the amounts existing at the time of program transfer. Accordingly, actual costs incurred by municipalities in subsequently delivering these programs were not being taken into account in determining CRF entitlements.
- 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 that varies according to the size of a municipality, and the Ministry had insufficient empirical or

analytical support for this approach. Furthermore, since \$1.3 billion in LSR programs were still administered by the province, the savings target presented municipalities with the challenge of finding savings in programs that they did not control.

- Because of the intricacies of the CRF funding formula, savings targets had had no effect on some 72 municipalities that experienced annual windfall gains from the LSR initiative. 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 arising from the latest province-wide current value assessment. Updating the tax-room component of the CRF funding formula would have increased the CRF entitlement of some municipalities and decreased the entitlement of others.

With respect to program administration, while we concluded that overall system controls and procedures were adequate to ensure that CRF payments were properly authorized and processed, we recommended that the Ministry improve its monitoring of municipal use of CRF funds, implement procedures to recover or minimize CRF overpayments, and improve the timeliness of providing CRF information to municipalities.

The Ministry responded to our recommendations with commitments to either take corrective action or to consider our recommendations in its current review of the CRF program.

## CURRENT STATUS OF RECOMMENDATIONS

The Ministry of Finance advised us that it has considered all of our recommendations from the *2001 Annual Report*. The Ministry's response to our recommendations has resulted in administrative improvements to certain components of the program, as well as a commitment to an annual update of the active program data that determine funding eligibility. The Ministry also advised us that it had responded to some recommendations by seeking and obtaining confirmation from the government of its policy framework for the CRF. The current status of each of our recommendations is outlined below.

### REVENUE NEUTRALITY

#### 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.*

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*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.*

### **Current Status**

In 2001, prior to the release of our report, the Ministry completed a review of the CRF program. As part of the review, it consulted with municipalities to determine whether to continue with the existing CRF funding model or to adopt an alternative model. Based on the input received, the government decided to maintain the CRF with some administrative improvements.

We understand that the continuation of the CRF approach to municipal funding has been reaffirmed by the government. Notwithstanding our previous concerns, the Ministry maintains its position that revenue neutrality has been achieved through the operation of the formula guiding the CRF Base calculation—namely, that municipalities whose LSR costs exceed the residential tax revenues granted to them in 1998 are eligible for a CRF Base Grant. The funding allocations arrived at through this CRF Base calculation reflect government policy and represent, by the Ministry's definition, the performance indicator of revenue neutrality.

With respect to our concern that the costs for fully transferred programs (that is, programs that are no longer administered by the province and are not cost shared) were frozen at the level existing at the point in time the program transferred, the Ministry indicated that this continued to be the case for the majority of fully transferred programs, including: Children's Aid Societies; Public Housing; Airports; Septic Inspections; Gross Tax Receipts; and Property Assessment. However, the Ministry informed us that the fully transferred Farm Tax Rebate and Managed Forests/Conservation Land Rebate programs have now been reclassified as "active" programs. Accordingly, LSR costs associated with these programs will continue to be updated annually. Furthermore, since our audit, the province has taken back full responsibility for both the operating and capital costs related to GO Transit. In addition, it has assumed one-third of the capital funding costs related to Municipal Transit (operating costs, however, continue to be frozen).

With respect to our concern that the current value assessments (CVAs) on which municipalities based their property taxes, and hence on which the “tax-room” allocations used by municipalities to help fund LSR costs were based, had not been updated by the most recent CVA changes, the government has decided that it will not update the tax-room allocations to reflect the most recent CVA changes. However, the Ministry has advised us that LSR costs for the Farm Tax Rebate and Managed Forests/Conservation Land Rebate programs will continue to be updated to reflect the most recent CVA data.

A third concern in our *2001 Annual Report* was that the government required municipalities to achieve varying amounts of savings (depending on municipality size) as part of its calculation of CRF entitlements—without ensuring that the savings targets were supported by empirical or analytical evidence. The Ministry advised us that the government has reviewed and confirmed that the original CRF formula, which incorporates municipal savings targets, will continue to be used to determine municipalities’ CRF Base allocations. Accordingly, the required municipal savings targets have remained unchanged since 1998.

## **CRF BONUS AND 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.*

### **Current Status**

The 2002 Community Reinvestment Fund (CRF) payments included the CRF bonus and supplementary-assistance components. In addition, the government paid a Transit Bonus to offset any reduction in CRF entitlements resulting from lower municipal transit capital and GO Transit costs when the province took back responsibility for the Municipal Transit and GO Transit programs. The Ministry advised us that the government has reviewed and approved the continuation of these components of the CRF and accordingly, funding allocations reflect that policy approval.

## **PROGRAM ADMINISTRATION**

### **Monitoring of Municipalities**

#### **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;*

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- *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.*

### **Current Status**

Subsequent to our 2001 audit, the government rescinded its policy of barring municipalities from allocating CRF funds to local reserve accounts. The current policy is that the decision whether or not to use CRF funds immediately is a local one. The Ministry has also streamlined its reporting requirements for municipalities in 2002 and 2003 by eliminating areas where information requests were previously duplicated.

The Ministry has also taken the position that monitoring the use of CRF funds by municipalities infringes on municipal autonomy and may restrict budgetary decisions. Given that municipalities are primarily accountable to local taxpayers, the Ministry's view is that this accountability relationship is in itself a monitoring tool. As a result, the Ministry was not planning to follow up with municipalities to determine whether tax increases reported by municipalities were in accordance with CRF program requirements and whether municipalities that experience annual windfall gains as a result of Local Services Realignment (LSR) have used these gains for the benefit of local taxpayers.

## **Overpayments**

### **Recommendation**

*To ensure that the 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 occurrences.*

### **Current Status**

Following our 2001 audit, the government originally planned to adjust the 2003 CRF entitlements of those municipalities that received an overpayment in 2001. This process would have allowed municipalities with CRF reductions sufficient time to budget for their funding decrease. Municipalities were notified of this through a letter signed jointly by the Deputy Minister of Finance and the Deputy Minister of Municipal Affairs and Housing in November of 2001.

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However, the government made a subsequent policy decision to keep the 2003 CRF payments at the same level as the 2002 payments. Accordingly, there has been no recovery of previous years' overpayments.

## **Municipal Information Requirements**

### **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.*

### **Current Status**

The Ministry has committed to informing municipalities of the amount of their Community Reinvestment Fund (CRF) entitlements before the beginning of each municipal fiscal year. Accordingly, CRF allocations are now to be announced each October. In the fall of 2001, municipalities were advised of their 2002 CRF allocation. Similarly, the 2003 allocations were announced in the fall of 2002.

The Ministry advised us that it has also improved the transparency of CRF data. Previously, the year-end reconciliation data for some programs were based on interim estimates of program costs. The administrative improvements introduced in 2001 now ensure that CRF payments are reconciled to actual, final LSR program costs for active programs for all municipalities.