ALGONQUIN COLLEGE	
Presentation to:	Board of Governors
Subject:	Proposal to Establish a Contingency Reserve Fund in the College's Net Asset Accounts
Date:	June 11, 2012
Presenter(s):	Duane McNair, Vice-President, Administration on behalf of the Audit Committee

Purpose:

Supported by the Audit Committee, Administration will present a proposal to establish a Contingency Reserve Fund balance within the College's Internally Restricted Net Asset accounts (ie. akin to the 'equity' accounts on a Not-for-Profit entity's balance sheet) with the capacity to absorb adverse financial results within a fiscal year.

Background:

At the April 11th, 2011 Board of Governors meeting, discussion arose on whether or not the College was maintaining adequate contingencies to protect itself from significant adverse fiscal events.

The College develops its annual budgets in a prudent and fiscally responsible manner and ensures that there are appropriate funds held as operating contingencies to respond to various unexpected expenditures. The 2012/13 Approved Budget has budgeted contingencies totaling $6.1 million to fund expenditures that cannot be anticipated or that may be recurring but are generally difficult to estimate. These expenditures include sick leave backfill costs, pension buyback for new full-time employees with accrued pensionable service, sick leave buyouts, exceptional performance incentive compensation, grievance arbitration settlements and contingency funds to absorb the impact of tuition or grant shortfalls. These contingency provisions are maintained year over year in the College's operating budget. In addition, the College annually budgets for a $1 million net cash flow surplus which is also available to absorb financial losses beyond what may be absorbed by the contingency budgets.

Aside from the operating budget, the College maintains a $1 million unrestricted net asset balance. This balance is not a component of the operating budget but can be viewed as a 'savings' account balance that is maintained year over year and may be accessed if the College were to experience an adverse financial event that exceeded the capacity of the operating budget. However, relative to the College's $275 million operating budget for 2012/13, this $1 million account balance would not be considered a sufficient amount to deal with a significant adverse event.

Discussion/Considerations:

It is proposed that the College establish and maintain a formal Contingency Reserve Fund in the Net Asset accounts equal to 3% of operating revenues. Based on the 2012/13 Approved Budget, 3% of operating revenues would be calculated as follows:

Total Revenues	$ 324,606,000
Less: Revenues related to Strategic Investments	(48,796,000)
Operating Revenues	275,810,000
	X 3%
Proposed Contingency Balance	**$ 8,274,300**

The rationale for a Total Contingency Balance based on 3% of Operating Revenues is as follows:

- Expressing the contingency as a percentage relative to operating revenues (as opposed to an absolute fixed amount) ensures that the contingency balance is regularly updated to keep pace with College growth.

- The Contingency Reserve must be both reasonable and affordable. This proposal requires that a specific amount be reserved and maintained in perpetuity to ensure that the College always has the capacity to absorb the impact of adverse events. Relative to the total College operating budget, the opportunity cost of holding these funds for this singular purpose is deemed to be less than the benefit of the fiscal protection provided by a Contingency Reserve.

- An example of an unexpected adverse event that would result in a financial impact of $8.2 million would be a 10% decrease in operating and enrolment funding from the MTCU. While such a significant event would have a very high impact on the College's budget capacity, the likelihood is low over the longer term (the last time a funding decrease of an even greater magnitude was realized was in 1995/96). Effective risk management considers the likelihood and the impact together when formulating risk mitigation strategies.

For comparison purposes, George Brown College maintains a General Contingency of $13 million within their Internally Restricted Net Asset balance while Humber maintains a balance of $9 million. Humber's balance is also based on 3% of operating revenues.

It is proposed that this Contingency Reserve Fund be accumulated over a 3-year period. In that three year period, we will use the existing $1M net cash flow plus $1.75M to fund the new Reserve Fund.

- 2012/13: $1 million budgeted net cash flow surplus + $1.75 million from previous year end results.
- 2013/14: $1 million budgeted net cash flow surplus + $1.75 million from previous year-end results.
- 2014/15: $1 million budgeted net cash flow surplus + $1.75 million from previous year-end results.

The Contingency Reserve Fund would be fully implemented by 2015/16 and be topped up thereafter as per the calculation on budgeted revenues above.

In conjunction with the establishment of this fund, it is proposed that the College discontinue budgeting a $1 million net cash flow each year beginning with the 2015/16 fiscal year. The $1 million budgeted net cash flow was intended to be a contingency to deal with unexpected adverse events. Once the Contingency Reserve Fund is established, this $1 million budgeted net cash flow contingency will not be required. Once fully implemented, the amount of this Contingency Reserve Fund will be determined each year by calculating 3% of operating revenues and deducting the existing unrestricted net asset balance.

Recommendations:

That the Board of Governors approves the establishment of a Contingency Reserve Fund account within the College's Internally Restricted Net Asset accounts that is equal to 3% of operating revenues and will be phased in with full implementation by 2015/16.

That the College prepares its annual budgets in a manner that always produces positive projected fiscal year-end balances of its Unrestricted Net Assets plus Internally Restricted Net Assets beginning with the 2012/13 fiscal year.