

# Municipal Affairs

## SUMMARY

### DEPARTMENT

#### Matters from the current audit

Disaster recovery program (DRP)—updating the estimated liability—see below

## FINDINGS AND RECOMMENDATIONS

### DEPARTMENT

#### Matters from the current audit

#### Disaster recovery program (DRP)—updating the estimated liability

##### Background

The Department of Municipal Affairs administers and manages the funds and programs needed to recover from significant natural and other disasters. The department's disaster recovery program provides funding for residents, small businesses, agricultural producers, municipalities and other government departments when events like overland flooding cause uninsurable damage and loss. The Alberta Emergency Management Agency is responsible for administering these programs. AEMA is part of the Department of Municipal Affairs.

When the Lieutenant Governor in Council declares a disaster, AEMA estimates the total expected cost for the emergency and the department's financial services branch records the total expected expense and associated liability in the department's financial statements.

Disasters can involve widespread damage as well as damage to significant infrastructure. The costs of disaster recovery may be eligible for cost sharing with the Government of Canada through Public Safety Canada's Disaster Financial Assistance Arrangement. Five years or more can pass from the time of the disaster to the time the damage is repaired and the department submits expenses to the Government of Canada for reimbursement.

Provincial disaster recovery costs, and the revenue from the Government of Canada for disaster recovery, are often significant to the department's finances and, occasionally, to the Government of Alberta's finances. This is particularly true for the 2013 southern Alberta flood, which was significant to both the department and the Government of Alberta. The 2013 southern Alberta flood created a heavy demand on the government processes to deliver financial assistance and recovery funding. In 2014 the department estimated the total eligible DRP costs for the 2013 southern Alberta flood at \$2.4 billion and recorded this as an expense in its financial statements. In 2015, using more current information, the department updated its estimate to \$1.6 billion, a decrease of \$756 million. As of March 31, 2015, the department had a liability of \$699 million for claims it had not yet paid.

Before January 2014, the department relied on a contracted service provider for all engineering and claim assessment services related to municipalities, residents, small businesses and agriculture producers. The service provider estimated the extent of damage, assessed the claims and calculated the claim payout.

In March 2014 the department announced that it was not renewing the service provider's contract, effective March 2015. Over the past year, AEMA has taken over the former contractor's responsibilities and undergone a significant transition to build capacity and develop expertise internally. AEMA had to design and implement systems to deliver financial assistance through the transition, while simultaneously processing the remaining outstanding DRP claims and updating the estimated DRP liability.

#### **RECOMMENDATION 16: IMPROVE SYSTEMS FOR UPDATING THE ESTIMATED DISASTER RECOVERY PROGRAM LIABILITY**

We recommend that the Department of Municipal Affairs develop and implement an improved method for updating and supporting its estimated disaster recovery program liability.

#### **Criteria: the standards for our audit**

The department should periodically update its estimates of disaster recovery liability, using a standard methodology and assumptions that are reasonable and supportable.

Management should review its updated estimates for DRP liability and supporting analysis to ensure they are accurate, supported and based on a standard methodology.

#### **Our audit findings**

##### **KEY FINDINGS**

- The department did not have an adequate process for updating its estimated DRP liability. Management could not support significant assumptions behind their estimates at March 31, 2015.
- The support for the estimate was not at a sufficient level of detail to identify material inaccuracies. The department made material adjustments to its draft financial statements because of these inaccuracies.
- The department's financial services branch did not receive sufficient information from AEMA to satisfy itself that the updated estimate was reasonable.

We examined the department's systems for updating the estimated liability for claims remaining at March 31, 2015. We found significant problems with these systems. Because of our findings, the department reduced its updated claims payable estimate by \$265 million and the amount expected from the Government of Canada by \$130 million. This \$265 million reduction included \$243 million for the 2013 southern Alberta flood. The \$243 million is part of the \$756 million reduction in the department's updated estimate.

#### **Methods for updating the estimated DRP liability**

Estimating liability for disaster recovery claims is a complex task. As more information becomes available, cost estimates may change significantly from the original estimate. The department should forecast known factors such as the number of claimants, as well as unknown factors such as the extent of damage, inflation and other project risks. As the department obtains new or better information on the extent of damage or project scope, and more accurate cost estimates and actual expenses become available, the estimate should become more accurate.

We found that the department did not have an adequate process for updating its estimated DRP liability. The department used various methods, based on different disaster programs and types of damage, to estimate its liability. The department started with estimates from its contracted service provider for the majority of the claims. AEMA management then made significant adjustments to these estimates for other factors that the service provider did not take into account.

The department could support some of these adjustments; others it could not. The adjustments were often based on management's judgment rather than on supportable evidence. As a result of our audit, the department reduced its March 31, 2015 estimated DRP liability by \$62 million for adjustments it could not support.

Other Alberta government departments manage disaster recovery projects such as repairs to bridges, buildings, parks and roads. Since the department administers all DRP funds, it is responsible for recording the estimated expenses for all of these projects. It is also responsible for obtaining the updated estimated liability from the departments which manage these projects. We identified three weaknesses with this process.

- Information to support estimates not obtained—The department does not require other departments to report whether their estimates include reserves for contingency or other factors that might escalate costs.
- Project status and risks not tracked—The department does not ask for non-financial information such as project status, changes in project scope, percentage complete, estimate accuracy or risks which may affect the estimated liability. A more thorough project update would help the department assess the reasonableness of the estimated liability.
- Management review not required—The department does not require senior management in other departments, responsible for the managing these funds, to review or approve the estimated liability.

After the department estimates its liability for claims not yet paid, it also adjusts the contingency reserve and records the reserve as a liability in its financial statements. The contingency reserve is for unknown risks that could affect the cost of the disaster recovery programs, such as unknown claims, scope changes, inflation or cost overruns. If other departments are also including contingency reserves in their estimates, the total reserves set aside for contingencies might be too high.

At March 31, 2015, the department recorded a contingency reserve of approximately 13 per cent (\$79 million) of the remaining claims payable for the 2013 southern Alberta flood. Although the department calculates the reserve using a percentage of the estimate for outstanding claims, it does not have a documented or approved method for deciding on the contingency reserve percentage. Nor does it have a robust analysis to support the reasonability of the reserve. It is also not clear how management adjusts the contingency reserve as time progresses and unknown factors, such as project scope and costs become known or more certain.

The department has been including contingency reserves in its disaster recovery estimated liability for several years. However, it has not completed an analysis to assess the accuracy of the reserves. A historical analysis, based on actual experience, could provide the department with valuable information for developing and supporting its contingency reserve methodology.

#### Support, analysis and review of the DRP liability

Management's review of the DRP liability at March 31, 2015 was not at a sufficient level of detail to identify material inaccuracies. One of the DRP balances listed over \$630 million in remaining claims payable at March 31, 2015. AEMA was initially unable to tell us how much of the \$630 million related to private sector, municipal and temporary accommodations. After significant manual effort, AEMA was able to delineate this balance by claim type. AEMA also identified a \$158 million liability which was

recorded for temporary accommodation claims, but was no longer valid. AEMA re-examined the estimated liability for other disaster programs and found an additional \$45 million that was no longer valid. The department subsequently corrected for these inaccuracies.

AEMA created a majority of the support and analysis for its March 31, 2015 estimated liability after our request. We expected AEMA would have done this analysis as part of its process to update the estimated liability in the department's financial statements. The AEMA executive director would also have needed this level of support for his review of the estimate.

#### Review of the estimated DRP liability by financial services

The DRP expense, liability and associated revenue and receivables from the Government of Canada are significant estimates within the department's financial statements. AEMA is accountable for updating its estimates and providing these updates to the department's financial services branch. The financial services branch is accountable for producing accurate and complete financial reports for the department, including financial statements.

The financial services branch relies on AEMA to provide updated estimates of DRP liability. The department's financial services branch did not receive adequate information from AEMA to satisfy itself that the financial information that AEMA provided was accurate, complete and useful for the department's financial reporting purposes. Other than a continuity schedule of opening claims payable, payments, adjustments and remaining claims payable, we could not find any other robust support or analysis provided to the financial services branch to support AEMA's estimated DRP liability at March 31, 2015.

#### Implications and risks if recommendation not implemented

Management can expect and accept some uncertainty in estimates for the cost of recovering from a disaster. However, the degree of uncertainty increases unacceptably when the estimate is based on poorly designed systems. Inaccurate estimates affect the financial reports that users rely on for many types of decisions. Decision makers may not have the information they need to make the best decisions.

## OUTSTANDING RECOMMENDATIONS

### DEPARTMENT AND EXECUTIVE COUNCIL

Management has identified this recommendation as implemented—to be confirmed with a follow-up audit:

**Various departments—Contracting: Improve compliance with contracting policies**

—October 2014, no. 10, p. 62

We recommend that the Departments of Municipal Affairs and Executive Council:

- document the rationale for contracting services and selecting vendors when entering into sole sourced contracts
- follow proper contract administration and evaluation processes
- update their contracting policies to deal with situations where one department arranges for a contractor to perform services for another department

### DEPARTMENT AND ENVIRONMENT AND PARKS

The following recommendation is outstanding and not yet ready for a follow-up audit:

**Flood mitigation systems: Designate flood hazard area and complete floodway development regulation—March 2015, no. 12, p. 80**

To minimize public safety risk and to avoid unnecessary expenditure of public money, we recommend that the:

- Department of Environment and Parks identify flood hazard areas for designation by the minister
- Department of Municipal Affairs:
  - establish processes for controlling, regulating or prohibiting future land use or development to control risk in designated flood hazard areas
  - put in place processes to enforce the regulatory requirements

