



City Auditor's Office

Operating Budget Management Audit

March 5, 2020

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The City Auditor's Office conducted this audit in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Executive Summary

The City's 2019 Council Approved operating budget was \$4,027M¹ to support the 61 services delivered by The City. The Corporate Budget Office, within the Finance business unit, ensures that the operating and capital budgets for The City's eight departments in the Finance and Supply Chain Management financial system correspond with approved budgets. Department budgets are disseminated to business units within departments, and at the business unit level, budget is further assigned to DeptID owners. DeptID owners assume responsibility for monitoring and managing expenditure allocated to their DeptID.

The objective of this audit was to assess whether The City effectively monitors and manages operating budget to appropriately mitigate key risks: financial risk and reputational risk to The City. We did this by assessing the effectiveness of processes and tools utilized against The City's expectations of budget management and the Government Finance Officers Association's Best Practices of Budget Monitoring² published March 2018 (Appendix A).

Council Policy, CFO006 Budget Reporting Policies, sets forth procedures on reporting of budget variances and spending when there are variances exceeding \$400K or an unbudgeted emergency. The audit focused on the Executive Information Report because it is a consistent report shared to Council on a regular basis, and the content provides insight into the month-to-month budget monitoring activities. Fulfilling the reporting requirements of the Executive Information Report involves Finance staff and business unit staff providing analysis of the operating budget results and explanations for variances exceeding \$250K.

Our results confirmed The City's operating budget management and monitoring practices are in place and generally align with the seven Government Finance Officers Association's Budget Monitoring Best Practices which mitigate the key risks. We identified two areas to be strengthened for The City to have a comprehensive budget monitoring practice: Who is responsible and outlining roles, and Communication. Our recommendations assist Finance to address disclosure, effectiveness, and efficiency in its budget management process.

First, formally designating who is responsible and outlining roles strengthens operating budget monitoring and management by supporting effective use of resources and reducing potential duplication of work effort. Our review of The City's budget monitoring and management requirements observed that there is no "must do" directive policy or procedure on how budget elements should be analyzed or at what level of detail the analysis should be considered other than the Executive Information Report's instructions and guidelines. We confirmed budget element analysis is conducted, however, formal procedures are required to address roles and responsibilities which would provide assurance that The City's requirements are completed in an efficient and effective manner.

Second, communication of operating budget results is frequent, through the Executive Information Reports; however, budget information is not always sufficiently transparent. Specifically, budget variances are explained, but without identifying the root cause, the Executive Information Report

¹ 2019 Operating Budget Changes - PFC2019-1067. As at July 31: Total City Expenditure \$4,472M less internal recoveries (\$446M).

² <https://www.gfoa.org/budget-monitoring>

does not provide a record of what happened and why. Improved communication transparency will provide the report audience with enough information to understand the underlying reasons for the variances, how the variances could be mitigated or resolved, and if there will be an impact to subsequent year's operating budget.

Finance has agreed to both recommendations and has committed to set action plan implementation dates no later than December 31, 2021. The City Auditor's Office will follow-up on all commitments as part of our ongoing recommendation follow-up process.

1.0 Background

The City's 2019 operating budget was \$4,027M to support the 61 services delivered by The City. City operating expenditure is recorded in the City's Finance and Supply Chain Management (FSCM) enterprise system. Budget and actual expenditures, revenues, and recoveries are assigned to a DeptID owner, a position in the organization that has the responsibility to manage both people and budget. Budget and expenditure information is rolled up from DeptIDs to business unit (BU) level, and then up to department level across the Corporation. DeptID owners are assigned responsibility for monitoring and managing expenditure assigned to their DeptID. To support them in this role, DeptID owners can utilize reports from FSCM and the associated HR system, Human Capital Management, which provide information on revenue and expenditure related to their DeptID.

The Finance business unit's (Finance) objective, stated on The City's intranet site, is to help BUs perform their functions more effectively and efficiently by:

- Providing BUs with timely analysis and interpretation of data;
- Creating innovative ways to doing business through more effective ways of using resources and designing alternate processes;
- Providing corporate linkages and direction by linking financial objectives with the corporate vision, mission, values, and objectives, and the BU's business plans with budgets; and,
- Ensuring an appropriate long-term view of budget forecasting and business opportunities.

To fulfill this objective, Finance utilizes a network of Finance Managers who have responsibility for supporting a portfolio of BUs. The Finance Managers, supported by Finance Leads, Finance Coordinators, and Senior Accountants, support and assist BUs with review of financial and performance results, such as, identifying root cause of significant variances between budget and actual and performing trend analysis on a monthly and yearly basis. Each BU is assigned at least one dedicated Finance support position who provides monthly reports (e.g. expenditure analysis) and additional ad hoc internal management reporting to the BU. This support is customized to the needs of individual BUs.

The City's Corporate Budget Office (CBO), within Finance, hold the official record of the Corporate budget. The CBO has oversight function of the Corporation's capital and operating budget, including ensuring that BU budgets match the official Corporate budget record, and collating monthly analysis of expenditure compared to budget from BUs into a monthly report, the Executive Information Report (EIR) which is provided to Council. Council Policy CFO006 Budget Reporting Policies sets forth the procedures on reporting to Council on budget variances, adjustments and expenditure.

2.0 Audit Objective, Scope and Approach

2.1 Audit Objective

The objective of this audit was to assess whether The City effectively monitors and manages operating budget to appropriately mitigate key risks. The objective was achieved by assessing the effectiveness of processes and tools utilized against The City's expectations and the Government Finance Officers Association's (GFOA) Best Practices of Budget Monitoring (Appendix A).

2.2 Audit Scope

The scope of the audit included related processes and reporting tools utilized by DeptID owners to manage their operating budget/expenditure during 2018 and 2019. Underlying IT control systems, and the validity of input controls used to produce budget monitoring reports were not a focus of this audit.

2.3 Audit Approach

The audit approach included:

1. Interviews (group interview/survey) with Finance Managers and Leads and review of Finance supporting documentation including policies, documented processes and guidance, to assess City-wide budget management practices;
2. Review of specific BU budget monitoring tools and processes from a representative sample of five BUs and assess Finance's customized approaches to budget management. We selected DeptID owners from three of the five BUs for further interview and review of budget management and monitoring tools and processes; and
3. Comparison of City-wide budget management practices and BU customization against GFOA's Best Practices of Budget Monitoring (Appendix A).

3.0 Results

We compared The City’s operating budget management and monitoring practices to each of the seven key items identified in the GFOA Budget Monitoring Best Practices (Appendix A) and evaluated whether The City’s practices met The City’s expectations and best practices set out by GFOA:

1. What elements should be reviewed
2. How the elements should be analyzed
3. At what level of detail should the analysis be conducted
4. Who is responsible and outlining roles
5. Tools for conducting the analysis
6. Communications
7. Action.

Our results confirmed The City’s operating budget management and monitoring practices are in place and generally align with GFOA’s Budget Monitoring Best Practices. We identified two key areas to be strengthened for The City to have a comprehensive budget monitoring practice: 4. Who is responsible and outlining roles, and 6. Communication. Our recommendations assist Finance to address disclosure, effectiveness, and efficiency in its budget management process.

3.1 What Budget Elements Should be Reviewed

We identified 37 Finance staff whose responsibilities include operating budget support to specific BUs and whose work directly or indirectly contributes to the EIR. We surveyed them to further understand how they specifically support BU DeptID owners. We also conducted in-depth meetings with three BU DeptID owners. Through survey, interviews, and examination of documentation, we gathered information on what budget elements are reviewed.

The results of the surveys, interviews and examination of reports confirms The City’s operating budget monitoring processes meets expectations of reviewing budget elements outlined by the GFOA.

Budget Element	GFOA’s review expectation met	Audit observations
Revenue and Expenditure	✓	<ul style="list-style-type: none"> • Revenues and Expenditures are reviewed regularly by DeptID owners and Finance. All Finance staff surveyed said review is conducted monthly or more frequently.
Operations	✓	<ul style="list-style-type: none"> • Operations and the services provided are reviewed by DeptID owners. • Finance and DeptID owners track and evaluate trends; mitigation strategies to address variances are developed.
Economic Trends	✓	<ul style="list-style-type: none"> • Economic trends are monitored by the CBO and regular updates are provided to the Corporation and Council.
Performance Measures	✓	<ul style="list-style-type: none"> • The CBO reports budget results monthly through the EIR; the report includes financial data and related performance measures.

3.2 How the Elements Should be Analyzed

The analysis should be conducted in a way that: identifies root cause, timing and impact of variances is understood, interim reporting requirements are met; and, the basis of comparison are appropriate. We interviewed three DeptID owners (Section 3.1) to gain understanding of how the Elements are analyzed within individual BUs. The three DeptID owners relied on their previous experience, knowledge of the business, and guidance from experienced employees to review their budgets, discuss the results with management and suggest mitigation strategies. We reviewed three BU variances exceeding \$250K with each BU in our selected sample. The BU DeptID owners identified root cause of the variances and provided supporting documentation.

Our review of City budget monitoring and management requirements observed that there is no “must do” directive policy or procedure on how the Elements should be analyzed except for the EIR instruction and guidelines. As in Section 3.1, our audit confirmed that Elements are reviewed and analyzed, however, who should review, what should be reviewed, and, how the budget should be analyzed, is currently undefined by City policy and procedure. Recommendation 1 addresses defining roles and budget monitoring expectations (Section 3.4).

3.3 At What Level of Detail Should the Analysis be Conducted

Of 37 Finance staff surveyed regarding the level of detail with which the operating budget is analyzed, the majority indicated that revenues and expenditures are analyzed to prepare trend analysis and forecasts. In addition, survey results indicate Finance reviews the overall financial results and often conducts transaction analysis to ensure that system entries are coded correctly and make corrections when necessary. BUs that have a favourable or unfavourable budget variance exceeding the threshold (\$250K) must be explained by the BU, and the explanation is included in the EIR.

3.4 Who is Responsible and Outlining Roles

Through interviews with three DeptID owners and group survey of Finance staff, we confirmed DeptID owners are monitoring the operating budget under their responsibility. The extent to which the DeptID owners perform budget monitoring activities varies based on the complexities of each individual BU. Some BUs have internal work groups that provide a high level of detailed reporting to meet the BU’s need for interim reporting, operations and financial information and data to assess impacts to the operating budget.

Financial reports are available and accessible to all DeptID owners. Our survey of key Finance staff noted 76% acknowledged they regularly provide financial reports to the DeptID owners and 90% believed those financial reports were necessary for the BU DeptID owners to understand and manage the operating budget. Discussion with three DeptID owners confirmed those DeptID owners who received support (in the form of data, information, trend analysis and forecast) from their BU’s internal work group, had significantly less reliance on support from Finance. Information required to monitor operating budget, explain budget variances, create forecast and trend analysis was completed within the BU with the support of their internal work group.

Our discussion with selected DeptID owners (Section 3.2) confirmed two of the DeptID owners had taken PeopleSoft training provided by Finance. All DeptIDs we interviewed,

whether they had received training or not, relied on their previously acquired knowledge of budget management, on-the-job training, and mentoring from other employees in their work group. As well, Finance staff are available provide support to the business at the DeptIDs' request.

Finance developed and delivers Financial Analysis and Financial Management training in a classroom-style format to DeptID owners. The financial training manuals outline the responsibilities of the DeptID owners. However, DeptID owners are not required to complete financial training. Other than the financial training manuals, there are no other Finance policy or procedure that define and assign DeptIDs budget monitoring and management responsibilities.

Budgeting policies (CFO004 and CFO006) are silent on DeptIDs' budget monitoring requirements. The CBO, within Finance, has the responsibility to report and comment on BU budget variances that exceed a threshold of \$250K, however the CBO is not directed to follow up on variance mitigation plans and outcomes. Finance indicated that this activity is completed at the BU level, supported by Finance, and reported to Council individually if material or per CFO006.

The absence of budget monitoring expectations and accountability results in a mix of informal, and possibly duplicative budget monitoring practices and processes. As a result, we recommended roles and expectations of budget monitoring should be clarified to ensure duplication of work is not occurring and reinforcement of expectations through training (Recommendation 1).

3.5 Tools for Conducting the Analysis

We assessed use of the FSCM enterprise system in effective budget management and monitoring. Our discussion with Finance Staff and DeptID owners confirmed that all have access to the FSCM's data, which can be retrieved directly or through Finance's report repository. Finance provides training (Section 3.4) to understand and utilize three main financial reports which are available in the report repository: Internal Management Report (IMR), DeptID Analysis, and Activity Analysis. In our survey of 37 key Finance staff, 67.5% had the opinion that the FSCM's main financial reports did not provide enough information to the DeptID to monitor and manage operating budget. Of Finance staff surveyed, 92% said that they regularly create more detailed reports, using the FSCM, which provide a drilldown analysis.

Interviews with Finance staff and several DeptIDs (Section 3.2) confirmed that not all DeptIDs have had training to use the FSCM. To support another GFOA Best Practices (Who is responsible and outlining roles), it is essential that roles with responsibility for budget monitoring and management are trained to retrieve data and information from the FSCM (Recommendation 1).

3.6 Communications

Monthly, the CBO coordinates the production, review and communication to Council of the EIR, summarizing operating expenditure compared to budget by department and BU. The report is made available to Council through a shared intranet site. We reviewed the production process, and observed it provides a structured methodology to consistently examine expenditure each month, and support BU directors in understanding their financial position.

BU net variances over \$250K must be explained in the EIR. Finance Managers and Leads indicated in group interviews that it is informal City practice to adjust the budget (for example moving budgeted expenditure to a future month through the City's budget adjustment process, which is permitted in the CBO's guidelines). Explanations for account category variances are not required. As well, some self-supported BU budget-to-actual variances may net to zero due to transfers to/from specific financial reserves.

Communication of transparent analysis and results provides the audience with enough information to understand the impact of the results. The value of the reports is diminished if the end-user is not provided full transparency. While the EIR is the only monthly budget report provided, other mechanisms through which Council receives budget information includes the semi-annual Revisions Report and Accountability Report. We made a recommendation to strengthen operating budget results communication by assessing the reporting tool's use and disclosures (Recommendation 2).

3.7 Action

The GFOA's seventh and final recommended component for budget monitoring involves application of the six key areas listed above, to "ensure timely corrective action and operational improvement."

Our interviews with the DeptID owners confirmed activities such as trend analysis and forecasting within the BU to assist DeptID owners in gauging the magnitude of impact on the operating budget and responding with mitigation strategies.

We would like to thank staff from Finance and various BUs for their assistance and support throughout this audit.

4.0 Observations and Recommendations

We've made two recommendations to strengthen The City's operating budget management processes.

4.1 DeptID Essential Budget Roles and Expectations

Expectations for The City's operating budget monitoring and management have not been formally defined or assigned and as a result, there is a lack of role clarity between Finance and the BU DeptID owners.

The GFOA defines the fourth of its seven best practices for budget monitoring as:
"Who is responsible and outlining roles:

1. Production. Who produces the analysis, reports, etc. related to budget monitoring should be clearly articulated and disseminated.
2. Roles. Collaboration and ownership within the organization should be promoted to help provide context related to any potential issues.
3. Ownership. Identify who is responsible for resolving variances related to both spend and service delivery as well as any other problems identified that need attention."

Establishing essential budget expectations, supported by documented guidance and accompanying training, underpin effective and efficient budget monitoring and management. Without an established line of sight on the minimal expectations, and role responsibilities, duplication of activities may occur, which impacts the effective use of resources.

Our in-depth review of three BU roles and responsibilities identified occasions where both Finance staff and BU staff regularly send similar financial information to DeptID owners each month to support monitoring and management of budget.

We surveyed 37 Finance staff to gain clarity on the budget management and monitoring and results noted:

- Both Finance and BUs monitored expenditure (97%);
- Finance provides system-generated financial reports directly to DeptID owners (90%) because this has become standard practice, or because the DeptID owner relies on it even though DeptID owners can access these reports directly;
- Variations in BU budget practices require additional Finance support to facilitate effective budget monitoring and management (e.g. allocating budgets divided evenly over 12 months rather than using a forecast approach); and,
- DeptID owners require support to retrieve reports and monitor expenditures to detect and correct errors.

Operating budget monitoring requirements of DeptID owners are not documented in policy or procedures although there is some guidance provided in the Finance training. The training is not mandatory, and the guidance provided is limited to the following statements:

- "Managing the resources (i.e. people and financial) effectively and efficiently within the organizational unit
- Contributing to, monitoring and reporting on approved Business Plans and Budgets"

Recommendation 1

The City Treasurer:

- a) Clarify roles and expectations of budget monitoring between Finance and DeptID owners, and reduce duplicative tasks where identified.
- b) Document budget monitoring and management expectations, including assignment of responsibility to DeptID owners, BUs and Finance.
- c) Develop associated policy, process and related training to support defined budget monitoring and management expectations.

Management Response

Agreed.

Action Plan	Responsibility
<p>The City Treasurer will develop formal documentation to clarify roles and expectations of budget monitoring requirements for DeptID owners and Finance. Although, the audit scope is around the operating budget, actions to address Recommendation 1 will result in clarification of roles and expectations for budget monitoring for both operating and capital.</p> <p>Documentation may include policies, documented processes, and training materials plans. A communication and training plan will be developed and executed. Engagement with the Administrative Leadership Team (ALT) may be required in addition to engagement with BUs.</p>	<p><u>Lead:</u> City Treasurer</p> <p><u>Support:</u> Portfolio & Strategy Group Corporate Budget Office Portfolio Finance Managers</p> <p><u>Commitment Date:</u> December 31, 2021</p>

4.2 Transparent Communication to Council

Monthly operating budget and expenditure reported through EIRs to Council does not fulfill budget communication expectations of transparent communication.

GFOA’s budget monitoring best practice includes communication, specifically:

“Transparency: How can the information be shared on a wide spread basis to the community and include the proper context to best inform the public and minimize additional request for more information.”

Observations of The City’s practice to report budget variance:

- Review of 10 2018 EIRs. We observed that two explanations in one EIR (June 2018) were omitted at the BU’s request. Finance staff indicated that this was because the variances were due to timing and it was anticipated that the variances would be resolved in the following month.

- 15 variance explanations examined from eight EIR reports were confirmed to be accurate, however 100% of those explanations did not inform the reader whether the variance is an ongoing concern and could increase over time.

While Council receives additional information semi-annually through the Accountability Reports and Revisions Reports, as well as one-off reports if required on specific BU or service concerns with budget impacts, currently the EIR is the only comprehensive monthly report produced in the operating budget monitoring process provided to Council.

Recommendation 2

The City Treasurer:

- Assess whether the practices supporting the EIR completion can be enhanced and improved, or whether a different reporting tool should be implemented to provide Council with transparent communication.
- Ensure communication disclosed to Council through implementation of an effective report supported by appropriate guidance to DeptID owners.

Management Response

Agreed.

Action Plan	Responsibility
<p>Finance will consult with Council on potential enhancement to the EIR or changes to reporting requirements according to Council’s budget reporting needs. After consultation, feedback will be analyzed, and changes will be executed within available Finance resources. Finance will ensure changes are incorporated into the guidance for DeptID owners as part of Recommendation 1 if applicable.</p> <p>Recommendations will be developed, and follow-up consultation may be required before any changes are made.</p> <p>Formal documentation around purpose and roles and responsibilities will be developed for any changes made as a result of the consultation with Council on their budget reporting needs.</p>	<p><u>Lead</u>: City Treasurer</p> <p><u>Support</u>: Corporate Budget Office, Portfolio Finance Managers, and potentially other roles in the Corporation depending on change to be made based on consultation with Council.</p> <p><u>Commitment Date</u>: June 30, 2021</p>

Appendix A

Government Finance Officers Association: Best Practices Budget Monitoring	
1. What Budget Elements should be reviewed:	<p><u>1. Revenues:</u></p> <ol style="list-style-type: none"> 1. Seasonality, and whether comparable to prior observations. 2. Any potential volatility and the resulting impact 3. Trends and comparison to projections 4. One time sources 5. Timing of receipts 6. Relationship to economic indicators and potential impacts 7. Changes in policy/practice of overarching governments involved in disbursement of revenues 8. Review of patterns at other similar/related governments
	<p><u>2. Expenditures:</u> monitoring all expenditures, including one-time uses, and also examining key aspects of:</p> <ol style="list-style-type: none"> 1. Personnel. Examine additional detail beyond just regular payroll expenses. 2. Non-personnel. Monitoring current expenses as well as outstanding Purchase Orders, and major contracts to understand what was spent and what remains to be spent.
	<p><u>3. Operations:</u></p> <p>Are services being provided as anticipated? Are any services begin provided that were anticipated? What trends are being observed that may impact whether or not spending remains on track?</p>
	<p><u>4. Economic Trends:</u></p> <p>How is the broader context of prices for labour, services, commodities and other items impacting expenses versus the budget?</p>
	<p><u>5. Performance Measures:</u></p> <p>Incorporating into the budget monitoring process an examination of performance measures and linkages to financial outcomes. The analysis should include changes to goals/initiatives since budget adoption and are there new initiatives not initially included in the budget.</p>

Appendix A – continued

Government Finance Officers Association: Best Practices Budget Monitoring	
2. How the Elements should be analyzed:	1. Root Cause: beyond just identifying deviations from budget to analyzing and articulating why deviations occurred.
	2. Time frame: Is it anticipated that the variance will continue, or is there an underlying reason for it? How does the current spending pattern impact the subsequent year's budget?
	3. Requirements: Is the budget monitoring structured to meet any interim reporting requirements?
	4. Basis of comparison: Previous year actuals, Averages of several prior year actuals, Projections and forecasts.
3. At what level of detail should the analysis be conducted:	Consideration given to benefits of more versus less detail and its impacts on the timeliness, usefulness, and degree of difficulty to compile, among other factors. Potential levels at which to monitor are at Fund, Department, BU, Function, Project, and Activity level.
4. Who is responsible and outlining roles:	1. Production: Who produces the analysis, reports, etc. related to budget monitoring should be clearly articulated and disseminated.
	2. Roles: Collaboration and ownership within the organization should be promoted to help provide context related to any potential issues.
	3. Ownership: Identify who is responsible for resolving variances related to both spend and service delivery as well as any other problems identified that need attention.

Appendix A - continued

Government Finance Officers Association: Best Practices Budget Monitoring	
5. Tools for conducting the analysis:	1. Electronic systems: The org's ERP system.
	2. Automation: Data and reports should be integrated into and generated by an org's ERP system.
	3. Overspend Protection: Are there mechanisms in place in their ERP system to automatically prevent overspending of budget and notify the organization's financial leadership?
	4. Consistency: Off system analysis should be consistently applied to all aspects of monitoring the budget and clearly articulated to both staff conducting the analysis and end users.
6. Communications:	1. Frequency: How often budget monitoring reports and information is generated should be agreed upon at all levels of the org, but may vary for different program areas.
	2. Delivery: The point at which the monitoring process is achieved and how the information is communicated and to which stakeholder, both internally and externally, needs to be clearly structured.
	3. Format: How information related to budget monitoring needs to be clearly established as well, including considerations for the audience and their level of expertise.
	4. Transparency: How can the information be shared on a wide spread basis to the community and include the proper context to best inform the public and minimize additional request for more information.
7. Action:	Following the steps above; comprehensive monitoring and communication is conducted to ensure timely corrective action and operational improvement.