Budget Process Review
Status Report

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Introduction

The OCA's 2003 Annual Work Plan included participation in the review of the budget process being conducted by the Corporate Services Department. The City of Edmonton faces the same budget challenges that are confronting many North American cities. Inflation and service demands are rising faster than revenues. In its report to Council (*2004 Business Plan and Budget Context, Challenges and Options,* May 26, 2003), the Administration discussed many of these challenges and proposed alternative approaches to dealing with them.

As is the case for private and public sector organizations in general, the City is challenged with enhancing its budget process to more fully address governance and accountability matters.

Internal budgets are developed with the following considerations in mind:

- Requirements (e.g., legislative or demand-related) to deliver services or outputs
- Corporate plans and priorities
- External influences (such as input from other levels of government and citizens)

Objectives

This project was designed to provide assurance that the City's budget processes are designed to support effective governance and to identify potential enhancements of the current process structure. The review of budget activities was initiated by the Administration to identify ways to more effectively and efficiently manage resources, better control activities, enhance monitoring and management of financial performance, and more consistently achieve desired results.

Scope and Methodology

The three components of budget processes are developing the budget, executing the activities, and reviewing and managing performance. Budget development includes developing policy, parameters and guidelines through to obtaining executive approval. Executing a budget involves implementing the business plans and deploying the resources. Managing budget performance involves monitoring and modifying budgets as appropriate and holding managers accountable for performance. This project assessed all steps in the budget process.

The OCA's involvement in this project was proactive. The OCA provided ongoing best practice information and advice regarding appropriate controls and governance practices. Each process enhancement opportunity was discussed with the Administration along with potential implementation strategies. The OCA will continue to work with the Administration to adapt better practice methodologies to the City's operating environment.

During the course of the project, the OCA conducted the following reviews and analysis:

- Attended Corporate Business Planning and Budget sessions throughout the year to gain a broad understanding of the overall process that produces the annual budget.
- Reviewed internal resources, guidelines, procedures, and other documentation that are required to compile and deliver a City budget.
- Reviewed many reference sources related to internal budgeting including *Internal Budgeting – Better Practice Guide* (Australian National Audit Office), *Recommended Budget Practices – A Framework for Improved State and Local Government Budgeting* (Government Finance Officers Association), and budget process information collected from Canadian and other local governments.
- Developed a comprehensive internal budgeting process checklist (Appendix A) and used it to assess the development of the process that is being used to arrive at the City's 2004 budget.

Observations and Analysis

The City has received an international award for its budget development and presentation in each of the last six years, indicating that the overall budget process is recognized by an external agency as one which models better practices. Some opportunities were identified through this review that would even further strengthen the City's budget processes.

The comprehensive internal budgeting process checklist adopted by the OCA included 36 better practice attributes that are characteristic of effective internal budget processes in local government. This guideline focused on the following categories: financial management environment, building an efficient and effective budget development process, and reviewing and managing financial performance. The OCA worked with Corporate Accounting, Budgets & Reporting and others to assess the status of each better practice attribute identified. The possible outcomes were "Completed/Established," "In Progress," "Ongoing," or "Referred for Action." The category "Ongoing" was used to indicate that a longer-term effort will be required for implementation than for "In Progress" items. The following status was observed for the 36 better practice attributes at the time of this report:

- Completed/Established = 24 (the City has implemented this better practice attribute)
- In Progress = 6 (the City is moving toward fully implementing this attribute)

- Ongoing = 4 (the City has identified this attribute as requiring ongoing development and modification)
- Referred for Action = 2 (the City has not made significant progress toward implementing this attribute)

Appendix A contains a complete listing of the 36 attributes and a detailed commentary on each of them. Some of the better practice attributes identified as "Referred for Action" are not primarily the responsibility of Corporate Accounting, Budgets & Reporting Section. The Section should, however, play the role of facilitator as Senior Management Team considers adoption and implementation of these attributes. The following table summarizes the results of this review by budget process category:

Budget Process Category	Completed/ Established	In Progress	Ongoing	Referred for Action	Total
Financial Management Environment	4	2	3	0	9
Building an Efficient and Effective Budget Process	16	2	0	1	19
Reviewing and Managing Financial Performance	4	2	1	1	8
Total	**24**	**6**	**4**	**2**	**36**

In general, the City is in good position with respect to its financial management environment with a few areas for improvement noted. The budget process design is reasonably effective and efficient. Further process automation, integration of business planning and budgeting, and stronger focus on outputs would bring the City's process into full alignment with international better practices associated with the budget development process. Improvements in financial reporting to operational managers, requiring commentary on performance issues, implementing performance-based budgeting, and incorporating operational performance information into the existing financial performance reporting mechanisms would allow the City to even more effectively manage its budgets.

Conclusion

Because of the proactive nature of this project, formal recommendations have not been prepared. Rather, the OCA will continue to work with Corporate Accounting, Budgets & Reporting and the Corporate Business Planning Team to monitor progress in the development of the budget process and discuss additional opportunities as they are identified where processes may be further optimized.

Appendix A: Checklist of Better Practice Attributes in the Internal Budget Process

Better Practice Attribute	C	I	O	R
Financial Management Environment				
1. Has the organization established a budget committee to oversee the internal budget process? **Current State:** Senior Management Team functions as the City's Budget committee to: • Develop and recommend internal budget policy for approval • Oversee the internal budget and business planning including timetables • Set annual budget parameters and recommend guidelines for approval • Assess budget and prioritize proposed increases • Communicate results of business planning and budget process	✓			
2. Does the City Manager actively participate in the budget development process and recommend the budget for the year? **Current State:** The City Manager is the Chair of SMT and actively participates in the Budget process.	✓			
3. Are all internal budgets developed on the same basis used to prepare the Financial Statements? **Current State:** The City financial statements are not developed on the same basis as the Budget. Finance Branch is continually working to better align the two documents.			✓	
4. Does the organization have an ongoing program of improvement of financial processes? **Current State:** The City's ongoing program of financial improvements involves the following: • Identification and assessment of community needs, priorities, challenges for government services, capital assets, and management priorities; • Development of policies relating to stabilization funds, debt management, reserves, revenue diversification, balancing the operating budget, contingency planning, and one-time revenues. • Establishment of the Long-Range Financial Plan (LRFP). • Evaluation of past performance and making appropriate adjustments.			✓	

Legend: C = Completed/Established; I = In Progress; O = Ongoing; and R = Referred for Action

Better Practice Attribute	C	I	O	R
5. Do business plans include budgets and financial targets and are they developed and approved at the same time? **Current State:** The City is currently working to merge the business planning and budget processes. Better alignment of budgets with organizational priorities will allow more strategic assessment of the impact of reduced funding or changing priorities, increased understanding of the costs of activities, more consistency in monitoring staff performance, and greater staff commitment to desired outcomes.		✓		
6. Are internal and external budget documents consistent with each other? **Current State:** Information presented to the public and other levels of government (e.g., capital budget reporting to the Government of Canada and Government of Alberta on cost-sharing projects) is consistent with internal budget, business plans, and new policy proposals.	✓			
7. Do internal budgets integrate both capital and operating budgets, which are consolidated into budgeted Statements of Financial Activities, Operating and capital fund schedules? **Current State:** The capital budget identifies new asset purchases, all planned forecasts, planned disposals, and all costs that are to be capitalized as part of enhancements or internally developed assets. The combined capital and operating budgets are used to develop a City budget including a Statement of Financial Activities and Fund Statements as per local government accounting and PSAB standards.	✓			
8. Has the organization developed an asset management plan and estimated the costs by year for capital replacement? **Current State:** The city has established an Office of the Infrastructure through which planning and analysis of capital replacement programs is currently in progress.		✓		
9. Have managers' financial responsibilities been clearly articulated and incorporated into their performance agreements? In other words: • Manager's responsibilities are clearly defined and accepted; • Managers are held accountable regularly and consistently; • Managers are given authority to operate consistent with their responsibilities. **Current State:** Human Resources Branch has done some work in reviewing management competencies and incorporating them into performance agreements but a comprehensive program to which managers will be held accountable has not yet been developed.			✓	

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Better Practice Attribute	C	I	O	R
Building an efficient and effective budget development process				
10. Does the organization have an internal budget policy that is disseminated to managers and staff? **Current State:** The City does not have a formalized budget policy but does have guidelines and procedures that are developed, approved, and widely disseminated to provide appropriate authority to managers and staff to facilitate the budget process.	✓			
11. Have different budget reporting system/tools been assessed to see if they would improve the efficiency or effectiveness of the process? **Current State:** The budget preparation methodology exhibits characteristics of both zero-based budgeting and activity-based budgeting. Zero-based budgeting has been used to varying degrees in past budgets as required to achieve Council's budget guidelines. It is also used in developing and costing new activities. Activity-based budgeting is generally used in areas where Main-Link and other corporate activity tracking systems are used. The starting point for most City budgeting is historical expenditures adjusted for past financial patterns and inflationary impacts (incremental budgeting). Budgets are then adjusted using projected revenue estimates, identified savings opportunities, service growth impacts, and any recommended reductions to meet Council's budget guidelines.	✓			
12. Is there a dedicated team or identified resources responsible for managing the budget preparation process? **Current State:** Yes, the Corporate Accounting, Reporting & Budget Section of Finance Branch coordinates and monitors the budget preparation process, communicates objectives and strategies, and provides support, advice, and guidance to Departments.	✓			
13. Is the internal budget process reviewed or benchmarked against other organizations to ensure that better practices are adopted? **Current State:** Yes, the budget processes used in other organizations are regularly reviewed to identify better practices that could be adapted to the City of Edmonton environment to strengthen its budget preparation process.	✓			
14. Are detailed budget parameters and guidelines developed each year to facilitate the development of quality budgets? **Current State:** Detailed budget parameters and guidelines provide sufficient detail to facilitate the development of quality annual budgets that incorporate the City's objectives, strategies and priorities. Operational managers are involved in establishing the objectives, strategies, and priorities for each year's budget. In addition, the rules used to develop budgets are consistent with those used to record transactions in SAP, which contains the City's chart of accounts.	✓			

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Better Practice Attribute	C	I	O	R
15. Do operational areas prepare their own budgets and are they responsible for them? **Current State:** Yes, operational areas, with assistance from their finance partners, prepare their own budgets, which are then rolled up into both the department and City level budgets. Operating managers are then held accountable for budget performance throughout the year. In some cases, zero-based budgeting is used; in other cases, operational managers work from the previous year's budget and make adjustments based on anticipated changes to operations. Specialized software and analytical tools are used mainly for capital budgeting.	✓			
16. Has the budget preparation process been automated to improve its efficiency? **Current State:** The City's budget system is automated, but not fully integrated, resulting in a mix of tools and techniques being used to develop budgets. The Capital budgeting model that in use was intended to be an interim measure. The operating budget is developed using Excel spreadsheets and Access. An automated SAP budget model for both operating and capital budgets is being considered, but there are no implementation plans in place.				✓
17. Are mechanisms in place to assist managers during the preparation of their budgets including provision of access to finance area staff? **Current State:** Managers are provided instructions and toolkits to be used during budget preparation. Finance Branch staff members are then available to support managers as they develop their annual budgets. The Office of the City Clerk provides a communication forum for use throughout the process.	✓			
18. Are budgets supported by business plans and do the business plans include assumptions used to develop budgets? **Current State:** The City's Business Planning Team is currently working at more fully integrating the budget process into the business planning process. The current business-planning template includes the following topics: Key Highlights; Corporate Directions; Departmental Descriptions; Key Challenges (Forecasting and Trend Analysis); Corporate Business Plans and Departmental Initiatives; Performance Measures; and Financial Forecasts.		✓		
19. Does a budget committee or executive include quality assurance checks in the budget process to ensure quality of budgets prior to deliberation? **Current State:** The budget team evaluates the quality and accuracy of the budget before its deliberation by Senior Management Team. Senior Management Team then evaluates budget documents before presentation to Council. Quality checklists should be used in the future to demonstrate adherence to quality control processes and evaluation.	✓			

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Better Practice Attribute	C	I	O	R
20. Are managers consulted on changes to budget prior to conclusion of the budget process? **Current State:** Because managers are held responsible for managing to their budgets, they are consulted on all changes to the initial budget instructions. Changes or decisions to be made regarding budget issues are communicated to all stakeholders.	✓			
21. Does the executive or a budget committee test the validity and efficiency of budget submissions and assumptions for consistency with organizational priorities? **Current State:** By requiring each budget area to describe the impact on service delivery of budget reductions or variations in key assumptions that underlie the budget, internal budgets are tested for efficiency and validity before they are rolled up into the corporate budget presentation. The City currently completes various percentage scenarios during the budgeting process as well as service challenges and resulting impacts.	✓			
22. Is the budget approval process transparent and are decisions documented and communicated to managers and staff? **Current State:** The Corporate Accounting, Reporting & Budget Section and Office of the City Clerk communicate all budget changes and decisions regarding budget issues to management and Finance Branch staff in a timely manner.	✓			
23. If the organization is project driven, does it use a bottom-up approach to budgeting; or if it is process driven, does it use a top-down approach? **Current State:** The city uses a combination of the following approaches to budgeting. • **Traditional or incremental budgeting** uses the previous year's budget or actual results as a base line for current year funding. • **Zero-based budgeting** requires that each cost element be justified as though the activities are being undertaken for the first time. • **Activity-based budgeting** formalizes the process of planning and controlling an organization's activities to derive a cost-effective budget that satisfies forecast workloads and agreed-upon strategic goals. • **Output-driven budgeting** defines and projects the organization's outputs in terms of quality, quantity and timeliness and then identifies activities and resources required to deliver those outputs. • **Top-down budgeting** allocates budgets throughout the organization either by decision of senior management or by application of predefined rules. • **Bottom-up Budgeting** requires each operational area of the organization to prepare its budget based on its objectives for the year. The draft budgets are then evaluated at higher levels of the organization to determine which objectives will be funded.	✓			

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Better Practice Attribute	C	I	O	R
24. Does the organization drive its budget development from the outputs required rather than the organization's structure? **Current State:** The 2004 City budget planning process has shifted toward an output-driven budgeting process. Output-driven budgeting is accomplished by defining and projecting an organization's outputs in terms of quality, quantity, and timeliness and by identifying activities and resources that are required to deliver those outputs. Benefits include: • Allocation of resources to meet planned rather than historical volumes. • Identification of further efficiencies by identifying excess capacities. • Focussing on cost drivers rather than the effect of the driver (e.g., "what level of staffing is required?" rather than "salaries are increasing")		✓		
25. Are operational managers equipped to contribute to an accrual-based budget? Have they been provided with appropriate training on the financial management model applied in the organization? **Current State:** Accrual-based budgeting requires recognition of depreciation, profits and losses, and salaries and other costs to the operating areas to which they belong. The City uses a modified accrual based system of budgeting (e.g., depreciation is charged in utility and enterprise areas only). Benefits of an accrual-based budget include: • Managers are responsible for meeting their financial targets. • The full financial impact of a manager's decision are visible both to them and their stakeholders. • Internal decision-making is supported with more complete financial information; • Maintenance of dual cash and accrual systems can be eliminated; • An appropriate focus on systems and procedures for managing cash at the organizational level can be emphasized.	✓			
26. Does the finance area support operational managers by providing access to decision support tools and proactive input into key operational decisions? **Current State:** Finance Branch supports departmental management by providing skilled financial resources to assist management in making operational decisions. Those resource people are familiar with the operational requirements and the management framework being used. Therefore, they are able to provide clear and value-added financial support to managers, develop decision-support tools and guidance, empower managers to develop their budgets and establish their limits of authority, and take ownership of their operation's financial performance.	✓			

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Better Practice Attribute	C	I	O	R
27. Does the organization have effective processes to enable budget revisions to deal with changes in the environment and/or organizational priorities during the financial year? **Current State:** The City follows better practices in its practice of reviewing and modifying budgets during the year: • **Mid-year budget revisions** usually result from evaluation of major changes in the environment and addition of new projects. These revisions enable changes to be formally considered and to provide insight into the following periods budget. • **Internal transfers** are used to reflect changes in priorities, but should not be used to transfer money to achieve a balance for each line item. • **Rolling Forecasts** are used to project where the organization might go based on current budget vs. actual performance. By comparing the budget information to forecasts, managers are better able to make informed decisions reagarding action required to meet budget targets. The goal of budget revision processes is to ensure that an organization has control over its resources and retains the ability to hold managers accountable for total costs (not line by line).	✓			
28. Are managers provided with or have access to relevant financial information in a timely basis and in an effectively presented format? **Current State:** Through SAP and other corporate information systems, all managers have access (either directly or indirectly) to all financial information required for their decision-making.	✓			
Reviewing and managing financial performance				
29. Is the financial information that is available to managers consistent with their stated responsibilities? **Current State:** In most areas, systems are in place to support managers in carrying out their responsibilities. In some cases, new systems projects, such as Main-Link, will increase the level of information available to operational areas to better support them in carrying out their responsibilities.		✓		
30. Are reports presented to the executive based on a consolidation of lower level information, including a commentary on performance by line managers? **Current State:** Quantitative budget performance information is presented to Senior Management Team on a monthly basis. Other information, such as major project progress, accomplishments to date, etc. is not generally provided in current reporting formats.		✓		

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Better Practice Attribute	C	I	O	R
31. Is performance-based budgeting used? **A brief overview of performance-based budgeting:** Performance-based budgeting is becoming widely used as a tool to provide stakeholders with evidence that an organization's resources are being used effectively. In its pure form, program funding depends on achievement of established performance measures. To be effective, it requires that organizations develop meaningful performance measures that provide clear linkages between resources used and outcomes accomplished. While it is difficult to establish such linkages in a public-sector environment, use of outcome-based performance measures can significantly enhance budget deliberations – especially when linked with 'managing for results' methodologies. Research confirms that systemic implementation of performance measurements throughout an organization: • Supports improved communication within an organization, • Advancement of informed discussions about the results of government activities and services, and • Added value to budgeting decisions through the provision of relevant information about results as well as costs and activities. **Current State:** Although the City develops and reports performance measurement information through the corporate and department business plans, it does not use performance-based budgeting. Organizations like EPCOR, however, have implemented a form of performance-based budgeting.				✓
32. Is financial performance on the agenda, at least monthly, of executive meetings and does the discussion focus on the impact of the results on current and future operations rather than on the accuracy of the results presented? **Current State:** At the end of each month, Finance Branch closes the books and generates budget reports. Operational managers then analyze budget variances and forecasts, assess impacts on operations, forecast impacts for remainder of year, and discuss their current budget position with their superiors prior to forwarding their monthly budget status report to Finance Branch. Finance Branch then consolidates comments and forecasts for Senior Management Team and provides independent commentary for consideration and action. '	✓			
33. Are the results of executive management deliberations on budget and financial performance communicated to operational areas with relevant actions identified? **Current State:** Senior Management Team provides feedback on performance to both their operating areas and Finance Branch to ensure that any areas of concern are addressed by the appropriate areas.	✓			

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Better Practice Attribute	C	I	O	R
34. Are forecasts included in the management reports presented to the executive/ **Current State:** Budget reporting to Senior Management Team includes forecasts and Senior Management Team and/or Council address any concerns as appropriate.	✓			
35. Are budgets and financial performance results probed on the basis of "what does this mean for the future?" **Current State:** Following are some of the "so what" questions that members of Senior Management Team are likely to ask of Finance Branch during monthly budget presentations: • What is the projected budget result if the current pattern continues? • What is the likelihood that the current pattern will continue? • What action is required to meet overall budget targets for the current year? • What is the likely impact for ongoing service delivery? • What is the impact on future periods financial and operation priorities? • How is the organization positioned to respond to the projected inpacts? (This recognizes that it is important to monitor performance against budget and forecast results.)	✓			
36. Is the financial information presented along with operational information so that a balanced view of performance is obtained? **Current State:** Including additional performance information would enhance the City's budget reporting by clearly connecting budgets with performance measures. On its own, financial information does not complete the picture of organizational performance. The City's internal performance reporting should include (where applicable): • Budgeted, actual, and forecast operating costs and revenue – already in place • Asset and liability information – already in place • Key Performance Indicators and other operational performance measures as appropriate to support informed decision-making (e.g., unit costs of activities, quantity and quality measures, etc.) • Progress against plans • Periodic comparison against external data such as benchmarks where available • Commentary and analysis as appropriate to promote accountability			✓	

Note: The material in this appendix has been adapted from the Australia National Audit Office's *Better Practice Guide for Internal Budgets*, GFOA – Government Finance Officers Association publications, and articles from other local and national governments and industries.

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