



OFFICE OF THE  
**City Auditor**

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# Operating Budget Process Review

April 2, 2009

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The Office of the City Auditor conducted  
this project in accordance with the  
*International Standards for the  
Professional Practice of Internal Auditing*

## Summary for City Council

The City Manager is responsible for submitting the City's annual operating budgets and capital budgets to City Council (Council). As the City's governing body, Council approves funding for the operating and capital budgets. The Office of the City Auditor (OCA) observed the City's budget deliberations in 2007 and 2008.

The 2008 budget was prepared without ongoing dialogue between the Administration and Council. This resulted in the Administration's budget submission not matching Council's expectations, resulting in changes to be made late in the year. Our observations of the 2009 budget deliberations did not show an improvement in the disparity between Council's expectations and Administration's operating budget submission. This gap existed throughout the budget review and approval process, culminating in the unprecedented vote by three Councillors and the Mayor against the budget motion. In our governance advisory role to City Council, we chose to include this project as an Emerging Issue in our 2009 Annual Work Plan.

Our objective was to assess the City's operating budget process to identify improvements that could assist Council and the Administration make informed choices about the provision of services and the utilization of assets. Our overall conclusion is that while positive steps have been taken already in 2009, with more planned, the difficult decisions around service levels, priorities, and funding allocations will not disappear. Improved information flow and additional opportunities to discuss these issues should result in closer alignment between the Administration's budget submission and Council's expectations. Our review focused on five themes identified as having the greatest potential to improve the process. Based on the information and plans available at this time, we are encouraged by the actions taken and direction provided to strengthen the management controls and information submitted to Council for approval. We look forward to improved alignment between Council's expectations and the Administration's operating budget submission.

It is important to note that this is a review of the process used to develop the City's annual operating budget, and not a detailed review of the 2009 operating budget submission. We have attached a full report outlining the detailed results of our review. The purpose of this summary is to highlight the significant areas discussed in this review.

### **Role of the Chief Financial Officer**

In May 2008, the City appointed a Chief Financial Officer and Treasurer (CFO) to lead the newly created Finance and Treasury Department and focus on the financial policy and long-term fiscal strategy. To perform this role effectively, the CFO will need to understand Council's expectations, anticipate change and challenges, and provide fiscal expertise to ensure that the Administration provides reliable and meaningful information to Council to support their decision-making.

Currently, departments prepare reports that have capital and operating budget implications and present them to Council, often without the CFO's review and approval. This practice does not allow the Finance and Treasury Department to provide assurance that such decisions will not put the City at risk. The City needs to move from a decentralized responsibility for financial stewardship to that of effectively utilizing the CFO and his finance team as intended. This will assist in providing Council and the City Manager the assurance that a corporate group with fiscal responsibility has reviewed the information, and provided a perspective on major risks and impacts. We directed one recommendation to the City Manager to address this gap.

### **Information to Support Operating Budget Submissions**

On March 26, 2009 City Council approved the budget principles presented by the Administration. With all future budget information being based on these principles, City Council should expect improvements in the information they are provided and the Administration should become more efficient in the preparation of that information.

To support the 2010 budget submission, the Administration initiated a Service and Budget Review to consider the long-term budget and the services the City plans to offer. We support this initiative in that its results will enable the Administration to ensure that the services currently offered to Edmontonians are better aligned with achieving Council's priorities. This exercise should provide Council with assurance that the Administration has undertaken a rigorous review of its budget proposals prior to budget deliberations.

It is also essential that the CFO include the projected operating impact of approved capital investment decisions as part of the budget proposals as well as the potential funding timelines. Council requires full operating impact information when considering capital projects that require new operating funds. In the absence of this information, the City is at risk of incurring expenditures that have been approved in principle, but have no approved sources of funding.

We have observed a heightened level of communication between Council and the Administration in the first quarter of 2009. Timely financial updates along with more frequent, meaningful discussions about Edmonton's financial picture are positive and critical steps in this time of economic volatility. We believe that this should continue throughout the year, including a session for the Administration and Council to review a preliminary budget to confirm that the priorities and service level expectations are aligned prior to being presented for approval.

The Administration and City Council have made good progress to plan and initiate the first steps towards improving Edmonton's operating budget process. The application of the budget principles and continued communication will be critical. In our governance advisory role to City Council, we will monitor the revised operating budget process and look forward to improved alignment between Council's expectations and the Administration's operating budget submission.

# Operating Budget Process Review

## 1. Introduction

The Office of the City Auditor (OCA) observed the City's budget deliberations in 2007 and 2008 through which City Council approved the 2008 and 2009 operating budgets respectively. While these budgets were ultimately approved, there seemed to be significant misalignment between Council and the Administration throughout the budget review and approval process. This misalignment has been apparent for some time, but during the 2009 deliberations, it was confirmed by the unprecedented action of three Councillors and the Mayor by voting against the budget motion. Both City Council and the Administration have expressed their desire to reduce the level of friction for the 2010 and following budgets. In our governance advisory role to City Council, we chose to include this project as an Emerging Issue in our 2009 Annual Work Plan.

## 2. Background - Operating Budget Expenditures & Comparisons

The following tables and charts are intended to provide context and perspective on expenditures in Edmonton and other Canadian cities. Recognizing that each city has an individualized group of priorities, the comparison information is not provided to show whether Edmonton is better or worse, but rather to encourage City Council and the Administration to understand the ways in which Edmonton differs from other cities.

Table 1 outlines Edmonton's expenditures from 2005 to the 2008, by the services as categorized in the City's Annual Report to Citizens. The table includes the percentage of expenditures for 2005 and 2008 to highlight that service priorities have changed during that period. When comparing the relative allocation to total city expenditures, the Edmonton Police Service and Edmonton Transit System (ETS) continue to be the highest funded service areas. Expenditures for Emergency Response shifted from the 5<sup>th</sup> largest expenditure area to the 3<sup>rd</sup>; and Roadway and Parking shifted from 7<sup>th</sup> priority to the 5<sup>th</sup>.

The shifting of resources from one service to another is an indication that the relative priorities have changed over that time. This is appropriate as the City adjusts to evolving priorities, challenges and opportunities. The key is for City Council and the Administration to periodically look at expenditures from a corporate perspective (not necessarily at this level of expenditure categorization) and confirm that the allocation of resources matches the current environment and is consistent with City Council's strategic goals and priorities.

**Table 1 – City of Edmonton Expenditures (actual)**

Services Supported (millions of dollars)	2005	% of Total	2006	2007	2008*	% of Total
Police	193.3	16.4%	203.8	219.1	243.4	15.8%
ETS	179.2	15.2%	184.4	206.8	235.1	15.3%
Transfer to reserves & capital (note 1)	150.4	12.7%	170.9	138.6	138.8	9.0%
Parks, Community & Planning Services	136.2	11.5%	140.1	156.5	170.4	11.1%
Emergency Response	126.7	10.7%	136.7	153.1	171.9	11.2%
General Municipal (note 2)	100.4	8.5%	117.4	96.3	141.9	9.2%
Roadway & Parking	98.3	8.3%	120.9	126.4	148.6	9.7%
Corporate Administration (note 3)	87.2	7.4%	95.1	111.5	134.7	8.7%
Waste Management	59.6	5.0%	64.2	69.9	80.3	5.2%
Library	24.8	2.1%	25.9	28.3	31.6	2.0%
Debt Principal repayment	12.7	1.1%	14.3	18.4	25.7	1.7%
Bylaw Enforcement	10.2	0.9%	10.8	12.4	13.2	0.9%
City Council & Mayor's Office	2.9	0.2%	3.5	3.6	3.9	0.2%
<b>Total Expenditures</b>	<b>1,181.9</b>	<b>100.0%</b>	<b>1,288.0</b>	<b>1,340.9</b>	<b>1,539.5</b>	<b>100.0%</b>

Note 1 - Represents pay-as-you-go funding from municipal revenue for capital projects.

Note 2 - Consists of accommodation expenditures, tax expenditures, grants provided, subsidies to miscellaneous Boards and Authorities and general financial costs.

Note 3 - Consists of personnel and administrative costs for Corporate Services, Assessment & Taxation, Offices of the City Manager, Deputy City Manager and City Auditor.

\* Unaudited

The expenditures in Table 1 include funding for the City of Edmonton's Agencies, Boards and Authorities (City Agencies). These expenditures are further illustrated in Table 2. City Administration does not have control over these expenditures; rather they are managed by the City Agencies themselves. The level of City Agency funding however, is reviewed and approved by City Council.

**Table 2 - 2008 Approved Budget Expenditures – Edmonton Agencies, Boards & Authorities**

Agency, Board or Authority	\$ (000)	% of Total	% of City Expenditures
Police Service	238,631	73.7%	16.1%
Public Library	36,859	11.4%	2.5%
Economic Development Corporation	30,194	9.3%	2.0%
Space & Science Foundation	6,847	2.1%	0.5%
Arts Council	4,833	1.5%	0.3%
Greater Edmonton Foundation	3,500	1.1%	0.2%
Federation of Community Leagues	2,113	0.7%	0.1%
Taxi Cab Commission	616	0.2%	0.0%
	<b>\$323,593</b>	<b>100.0%</b>	<b>21.9%</b>

Table 2 shows that City Agencies account for \$323.6 million (22%) of the city's budgeted expenditures. This was funded by \$244.6 million (33%) of the \$745 million tax levy budgeted for 2008.

In 2008, Edmonton participated in a benchmarking study sponsored by the City of Saskatoon.<sup>1</sup> The study was based on the 2008 operating budgets for the cities of Edmonton, Saskatoon, Regina, Winnipeg and Calgary.

Studies of this nature are useful to provide general comparisons. However, due to cities having different populations, programs, and practices to capture and consolidate information, they should only be used to provide indicators of how one city compares to another.

The Saskatoon study included per capita<sup>2</sup> comparisons of various services. Per Capita, or per person, comparisons are generally more reliable as the basis for the comparison is more consistent. Table 3 provides budgeted dollars per capita information on three services. Because each of these services is distinct and definable, the comparison is more reliable as an indicator. This comparison shows that Edmonton spends more per capita than the other four cities for Police, Transit, and Street Maintenance<sup>3</sup> services.

**Table 3 - 2008 per Capita Expenditure Comparison – Western Cities**

	Saskatoon		Regina		Winnipeg		Edmonton		Calgary	
	\$ (000)	Per Capita	\$ (000)	Per Capita	\$ (000)	Per Capita	\$ (000)	Per Capita	\$ (000)	Per Capita
Police	58,231	\$288	53,783	\$300	167,811	\$265	238,631	\$327	278,357	\$282
Transit	28,696	\$142	22,481	\$125	110,997	\$175	221,530	\$303	269,271	\$272
Street Maintenance	9,880	\$49	13,294	\$74	66,266	\$105	100,611	\$138	80,712	\$82

<sup>1</sup> Robert Prosser & Associates Inc., City of Saskatoon Municipal Services Benchmark Project, October 2008. [www.saskatoon.ca/org/clerks\\_office/audit\\_reports/benchmark\\_report\\_final.pdf](http://www.saskatoon.ca/org/clerks_office/audit_reports/benchmark_report_final.pdf)

<sup>2</sup> Population figures are according to the 2006 census.

<sup>3</sup> Street Maintenance includes both summer and winter maintenance expenditures.

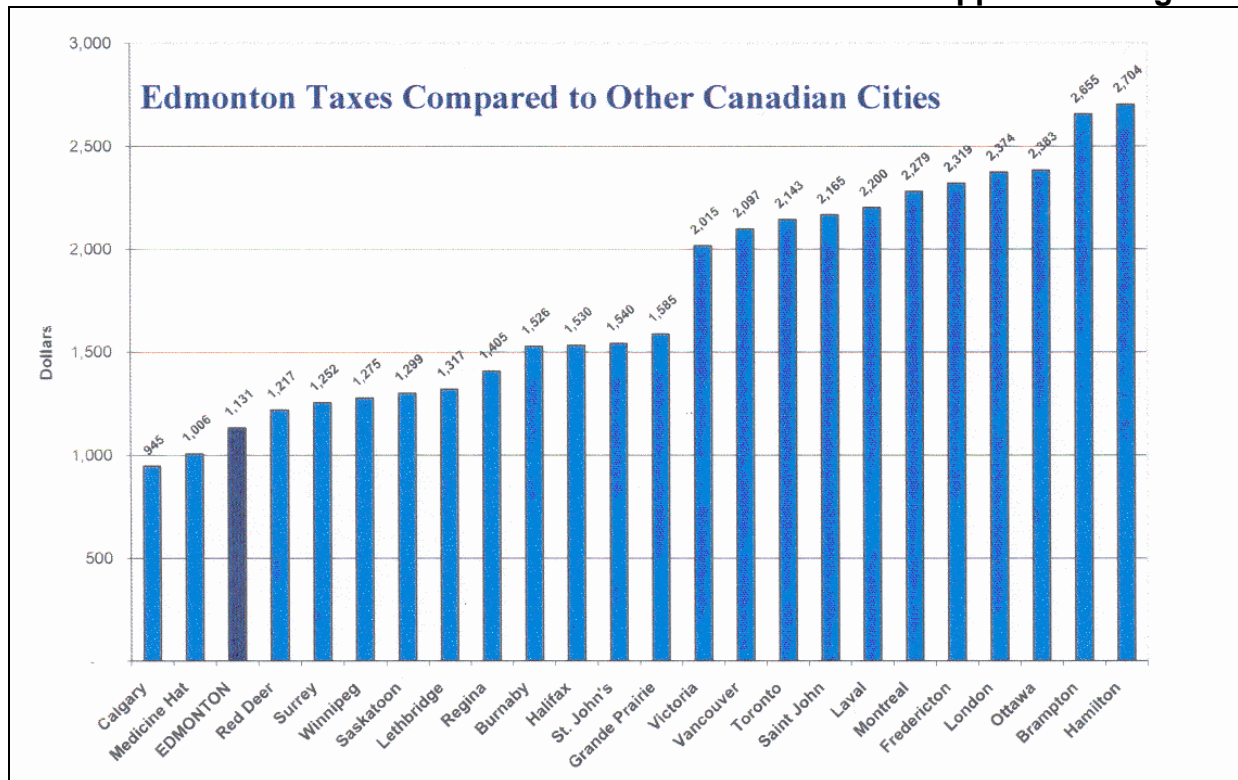
Municipalities are continually benchmarking against one another. Table 4 is a comparison of Taxation increases for major Canadian cities. Edmonton is highlighted as having the highest level of Taxation increases from 2001 to 2008.

**Table 4 – Percentage Property Tax<sup>4</sup> Increases for Major Canadian Cities 2001 to 2008<sup>5</sup>**

City	2001	2002	2003	2004	2005	2006	2007	2008	Total
Edmonton	2.8	2.4	3.5	5.0	5.4	2.9	6.7	7.5	36.2
Calgary	2.8	3.0	3.9	5.0	3.5	4.4	4.0	5.4	32.0
Vancouver	3.0	4.0	4.7	2.9	2.9	4.0	4.9	3.4	29.7
Toronto	5.0	4.3	3.0	3.0	3.0	3.0	3.8	3.8	28.9
Hamilton	1.4	4.6	3.6	5.6	3.2	2.2	3.4	3.6	27.6
Ottawa	0.0	0.0	0.0	2.9	3.9	3.9	0.3	4.9	15.9

As illustrated by Chart 1, property taxes can be shown from different perspectives. This chart is excerpted from Edmonton’s 2008 Approved Budget document. It compares property taxes in Canadian cities when school taxes are excluded. The comparison indicates that Edmonton has the third lowest property taxes in the nation.

**Chart 1 – Edmonton Taxes as Presented in Edmonton’s 2008 Approved Budget**



Edmonton’s property taxes were the third lowest in the nation, according to a 2007 survey of 24 major cities.

Source: 2007 Residential Property Taxes & Utilities Charges Survey, City of Edmonton, Planning and Development (Figures include municipal and regional taxes, but exclude school taxes.)

<sup>4</sup> Municipal property tax + education property tax = Property Tax

<sup>5</sup> [http://www.ottawa.ca/city\\_hall/budget/budget\\_taxes\\_en.html](http://www.ottawa.ca/city_hall/budget/budget_taxes_en.html)



The information in this section was intended to provide some insight into how Edmonton has spent its money and how those priorities compare with the priorities of other Canadian cities. High level comparisons with other cities, while useful as indicators, do not provide a measure of better or worse, simply what is different. At an organization-wide level, municipalities differ widely with each having its own distinct history and priorities. Some indicators, such as per capita comparisons, can provide more reliable comparisons than gross budget information. Significant differences should be viewed as indicators and then reviewed in further detail to understand the reason(s) why Edmonton's expenditures differ from those of other municipalities.

### 3. Objective

The objective of this review was to assess the City of Edmonton's operating budget process to identify improvements that could help City Council and the Administration make informed choices about the provision of services and the utilization of assets.

### 4. Scope and Methodology

This review focused on the process the City of Edmonton follows to develop, present, review and approve its operating budget. It is not a detailed review of the 2009 operating budget submission. Our review focused on the process followed in 2008 to develop the 2009 operating budget and the activities City Council and the Administration are undertaking to improve the process for developing the 2010 operating budget. We gathered insights into what works, what doesn't, and what needs to be changed by individually interviewing members of Council, Senior Management Team, and the budget development team. Our review included gathering and reviewing numerous publications regarding municipal government budgeting. The Government Finance Officers Association provides the following definition for a Municipal budget process:

The budget process consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets.<sup>6</sup>

The Government Finance Officers Association characterizes a good budget process as one that:

1. Incorporates a long-term perspective,
2. Establishes linkages to broad organizational goals,
3. Focuses budget decisions on results and outcomes,
4. Involves and promotes effective communication with stakeholders, and
5. Provides incentives to government management and employees.

We used these characteristics as part of our evaluation of the City's budget development process.

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<sup>6</sup> Recommended Budget Practices – A Framework for Improved State and Local Government Budgeting, National Advisory Council on State and Local Budgeting, Government Finance Officers Association, 1999

## 5. Observations and Analysis

### 5.1. Interview Results

Through our interviews, five areas were identified as having the greatest potential to improve the operating budget process. Following is a brief description of each area as well as a description of what is being done to address them in preparation for the 2010 operating budget process.

#### 5.1.1. Use Council's Vision/Strategic Plan to guide priorities

The City's resources should be allocated to the most important areas. In February 2009, Council affirmed that *The Way Ahead: City of Edmonton Strategic Plan 2009-2018* outlines the City's future direction. Some members of Council indicated that they did not have sufficient information to prioritize the Strategic Plan's 26 three-year priority goals.

In March 2009, the Administration initiated a Service and Budget Review. The City Manager indicated that this review will consider the long-term budget and the services that the City plans to offer. The service plans are to reflect City Council's desire to keep tax increases at a reasonable level and use Council's priorities and the Strategic Plan as a guide.

**OCA Observation:** Council confirmed that it intends the 26 three-year priority goals to guide the Administration's service plan priorities. The Administration's Service and Budget Review appears to be a good process. We believe that this process should be conducted annually to support operating budget submissions. The results of the current review should provide sufficient information to ensure that the Administration's services offered to Edmontonians are aligned with achieving Council's priorities. The Administration needs to communicate the results of this review and any resulting changes in service plans to City Council as part of the 2010 operating budget. The Administration should also ensure that it conducts formal annual service level reviews to support all future operating budget submissions.

On March 26, 2009 the Administration presented eight budget principles in a motion that City Council approved. Two of the Principles address our observations:

- ***The program service levels included in the base budget will be reviewed for alignment with Council's goals and priorities and any possible reallocations of budgets or efficiencies will be identified.***
- ***Budgets will reflect department's operational plans, performance measures and progress toward Council's strategic goals and priorities.***

### 5.1.2. Operating impacts of capital decisions must be understood

Organizations must commit associated operating funds throughout the life of each capital asset if they are to maximize returns on capital investments. Under the current budget process, at the time Council considers capital investments, the amounts of future operating fund commitments are not usually presented or understood. Similarly, the impact of those capital decisions on current and future operating budgets is not apparent. When Council approves capital infrastructure, that decision often increases the future operating budget requirement, yet the operating impact is discussed at a different time, often during budget deliberations several months later. A capital decision from the past that requires operating funds today essentially restricts City Council's flexibility to allocate operating resources (unless the capital investment is not used as was planned).

Capital project budget profiles typically include a five-year estimate of the impact on operations even though the project may span a few decades. Capital project budget deliberations focus only on the immediate capital expenditure. Its impacts on future operating budgets are typically not considered until it is addressed through the operating budget presentation when the asset is ready for use.

The budget team is working on developing an operating budget report that lists the approved capital investments and provides an estimate of the timing and level of operating funds to obtain the maximum benefits from that investment. This information is anticipated to be presented for the first time as part of the 2010 Operating Budget submission.

**OCA Observation:** City Council does not have sufficient information to evaluate the impact on future operating budget requirements while it is considering capital investments that will require new operating funds. Council needs full operating impact information when considering any capital project that will require new operating funds. To illustrate the significance of the issue, the budget team's preliminary calculation of the operating budget requirements for capital projects already approved is \$14.4 million for 2010, and \$9 million for 2011. The Chief Financial Officer needs to include the full operating impact of capital investments as part of all capital project proposals.

Other levels of government often provide funding for capital investments. With the difficult issue of determining a capital funding source already addressed, City Council may, without knowing the long term financial consequences, approve a capital investment that inadvertently creates a future operating sustainability risk.

To demonstrate the impact that capital decisions can have on future operating budgets and tax levy, in 2006 we calculated<sup>7</sup> that for every \$1 of capital spent on Transit, an additional \$1 of operating funding would be required over the next 20 years to maximize the investment. Using the South LRT extension as an example:

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<sup>7</sup> Transportation and Planning Branch audit

- Approximately \$700 million of Capital will be invested to build this extension.
- Once built, Transit's operating budget will need to grow by an additional \$700 million over the next 20 years in order to operate and maintain the service.
- Transit recovers between 45 – 50% (\$350 million) of operating costs through user revenues; the remaining \$350 million (50%) will need to be collected by increasing the city's tax levy over the next 20 years.

Two of the March 26, 2009 approved Budget Principles appear to address our observations:

- ***Capital budgets submitted for approval will include details of the obligation on future tax levy to cover the operating costs upon completion of the project.***
- ***All mid-year operating and capital budget requests require a source of funding and should be considered in light of other corporate priorities.***

In addition to all future Capital budget submissions including details on operating costs, City Council should also be provided the full operating costs of capital projects already approved, starting with the 2010 operating budget.

### **5.1.3. Lack of confidence in the base**

The Administration's methodology for developing its annual operating budget is to start from the previous year's base and add inflation and growth to generate the budget for the following year. The majority of Council members indicated that they do not have confidence in the base from previous years. Council members have also indicated that the Administration has not demonstrated that the base has been reviewed and is correct.

Many members of Council do not have confidence that the requested operating budget is based on a rigorous review. This issue erodes Council's trust and faith in the Administration's proposed operating budgets. The Administration's Service and Budget Review is expected to address this issue for the 2010 operating budget submission.

**OCA Observation:** The Administration's current budget development process ("build from the base") does not provide Council with assurance that the proposed budget is correct. This leads to an environment of mistrust where Council members take on the role of "the opposition" to determine whether elements of the proposed budget request are actually required.

We believe that City Council's skepticism about the accuracy of the base is warranted. The "build from the base" methodology, while efficient, does not acknowledge the uniqueness of the different business lines or acknowledge evolving service levels and service level priorities. When a satisfactory level of review is not demonstrated, City Council has reacted by directing "blanket, across the organization" cuts to the proposed budgets. Such a directive is evidence of a budgeting failure because the rationale for the requested budget, and the subsequent reduction, is not service-level or priority

based. In the same light, the application of “across the organization increases” is also evidence of a budgeting process failure.

Over time, the “build from the base” methodology has an effect similar to that of compounding interest. For illustration purposes, consider that an organization requires \$100 to provide a service in year one, and applies an annual inflation rate (interest rate) of 5%. Over the next ten years, the base of \$100 in year 1 escalates to \$163 in year 11 with no change in the level of service. This methodology, while efficient to calculate, does not provide confidence that \$163 is the amount needed to provide the same level of service in year 11, nor does it include an analysis of whether the level of service is appropriate, or even still required, 10 years later.

We believe that the Administration needs to enhance its budget development process by completing detailed annual reviews of operating budgets and service levels. The results and impacts of these reviews should be applied to the budget submission to demonstrate that the budget requirements are supported by appropriate rigor.

Two of the March 26, 2009 approved Budget Principles address our observations:

- ***The program service levels included in the base budget will be reviewed for alignment with Council’s goals and priorities and any possible reallocations of budgets or efficiencies will be identified.***
- ***Budgets will reflect department’s operational plans, performance measures and progress towards Council’s strategic goals and priorities.***

#### **5.1.4. Establish responsibility for the stewardship of expenditures and revenues**

The responsibility to oversee and manage the City’s expenditures and revenues is decentralized among members of the Senior Management Team. In mid-2008, the City Manager appointed a Chief Financial Officer and Treasurer (CFO) to lead the newly created Finance and Treasury Department and focus on the financial policy and long-term fiscal strategy. The City’s Finance and Treasury Department, led by the Chief Financial Officer as a member of the Senior Management Team, is positioned to oversee the financial management of the organization as a whole.

Currently, the Administration prepares reports that have financial impacts and presents them to City Council, often without the Chief Financial Officer’s review or approval. This makes it difficult, if not impossible, for the Chief Financial Officer to provide assurance to the City Manager and City Council that the financial implications of those reports will not put the City at risk.

**OCA Observation:** The current decentralized responsibility for financial stewardship places the City’s financial future at risk. Members of Senior Management Team

represent their departments and while they strive to make decisions based on what is best for the City as a whole; this can place them in a conflict position.

Adding the Chief Financial Officer to the Senior Management Team in 2008 presented the opportunity to ensure that the City’s financial position is protected and sustainable. In many organizations, the role of a Chief Financial Officer has evolved from the focused management and oversight of budget, accounting and finance activities to a strategic position that is responsible for managing the financial risks of the organization. Supported by the Finance and Treasury Department, the Chief Financial Officer has a clear opportunity to use his expertise and skills to take ownership of the responsibility to provide financial stewardship for the City.

Financial stewardship should be applied from an organizational perspective. This is not currently happening in the decentralized financial decision-making model. Members of the Finance and Treasury Department should be engaged in developing the financial impact portion of all Administration reports. We believe that the Chief Financial Officer should approve all Administration reports that have financial implications prior to presenting them to City Council.

<b>Recommendation</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that the City Manager ensure that all reports that have capital and operating budget implications are approved by the Chief Financial Officer/Designate.</p>	<p><b>Accepted</b>                      Comments: Finance and Treasury presently reviews all reports. This will now be changed to “approves”.                       Planned Implementation: Immediately                      Responsible Party: Chief Financial Officer</p>

**5.1.5. Work together throughout the budget process**

The annual process of developing annual budget guidelines and priorities in May/June, and then not communicating the funding implications of those guidelines until October/November when the budget is tabled, results in misaligned expectations and incomplete information to support Council’s decision-making. This pattern usually results in Council asking hundreds of written questions to the Administration, asking for more detail to support specific budget submissions.

City Council and the Administration recognize that they need to communicate more frequently throughout the operating budget development process to gain a common understanding of expectations and impacts.

The proposed 2010 operating budget process includes bringing improved information to City Council throughout the year by reporting 2009 monthly financial and organizational performance. This will provide timely information to City Council about the financial health of the City so adjustments can be made if necessary. Understanding the 2009

financial picture will also provide Council with better information to facilitate decision-making for the 2010 operating budget.

The Administration intends its Service and Budget review to provide a basis for preliminary 2010 operating budget information for Council's consideration in May/June. The results of this preliminary budget information and the assumptions upon which it is based, combined with current 2009 financial information, will provide City Council with vital information about the City's current and short-term financial health. This improved information can then be used to discuss the 2010 budget assumptions and priorities so that the Administration can develop appropriate detailed 2010 business plans and budget requirements. While the Administration has indicated that they would like a tax levy target to be set and then develop a budget to meet that expectation, members of Council were divided on whether this was the best course of action. Some Councillors indicated that the budget should be service delivery based and that the tax levy should be an outcome of the process rather than vice-versa.

Based on the outcome of the preliminary 2010 operating budget in May/June, the business plans and supporting budget requirements will be developed and then consolidated into a draft 2010 operating budget in the fall. The Administration should share the results of this draft budget with Council so that final adjustments can be made as necessary prior to presenting the proposed budget for approval in November/December.

**OCA Observation:** The new step (2009) of providing monthly financial and organizational performance information is a good one. The step of discussing a preliminary budget and the underlying assumptions early in the year is also a good one. This way the Administration does not waste its time and effort building a budget submission that is not aligned with City Council's expectations. We believe that an additional opportunity exists in the fall for the Administration to communicate the resulting preliminary business plans and budget requirements.

This combination of actions should provide Council with improved understanding of the final budget submission and its underlying assumptions and performance expectations. In the event that changes are required, this extra step would allow the Administration to make the appropriate adjustments prior to presenting the budget for approval at the end of the year. This could avoid the situation where Council directs the Administration to apply "across the organization" changes, which is an indicator that the budget development, review and approval process has failed.

Ongoing dialogue between the Administration and City Council is necessary to ensure that the Administration's business and budget planning process is aligned with the expectations of City Council. When expectations differ between what has been, and what can be done, the Administration and Council should discuss them as early as possible so that adjustments can be made and the Administration's efforts can be realigned with City Council's expectations. With the Administration's commitment to

provide City Council with more frequent information throughout the year, the draft budget will be important information to share and discuss.

Two of the March 26, 2009 approved Budget Principles appear to address our observations for 2010:

- ***The 2010 Operating Budget tax levy increase target will be based on the tax strategy that will be presented to Council June 2009.***
- ***Administration will identify service level impacts for any reduction strategies necessary to achieve the prescribed tax levy targets.***

We believe this principle should occur annually, rather than only apply to the 2010 operating budget.

## **5.2. Good Budget Characteristics**

We evaluated Edmonton's Operating Budget Process against the five good budget process characteristics provided by the Government Finance Officers Association. Our observations and comments follow.

### **5.2.1. Incorporates a long-term perspective**

Edmonton's budgeting process is evolving to improve consideration of long term impacts. New information regarding the impacts of previous capital decisions on current and future operating budgets is a required improvement. This needs to be enhanced by providing full operating impact information at the time capital projects are being considered. The 10-year and 3-year goals within Council's Strategic Plan also provide longer-term perspective to guide the City's budgeting priorities.

### **5.2.2. Establishes linkages to broad organizational goals**

City Council has affirmed that the City's vision and strategic plan provides the Administration with the City's budget priority areas. The stronger the linkage between budget expenditures and the City's goals, the greater the probability that those goals will be achieved efficiently and effectively. The results of the Administration's Service and Budget Review should serve to confirm the priority of service offerings and how they contribute to achieving the City's goals.

### **5.2.3. Focuses budget decisions on results and outcomes**

The Administration has embraced the need to integrate corporate planning and performance measurement with budget development. This gap in the current process will likely take more than one budget cycle to fully establish. The Administration is working to develop meaningful performance measures, not only for governance reporting, but also to aid day-to-day management. Determining relevant outcome-based measures for a complex organization like the City is a daunting exercise. Relating those



outcomes to the budget and to the City's Strategic Plan is a worthy goal for the 2010 operating budget, but it will more realistically be the start of a 3 to 5-year evolution.

#### **5.2.4. Involves and promotes effective communication with stakeholders**

Striking the right balance of communication with stakeholders and seeking relevant input for decision-making is difficult. City Council provides Edmontonians with numerous opportunities to engage in the budgeting process through individual contact with members of Council or presentations at Council or Committee meetings. The City obtained and evaluated citizen input as it developed the City's Strategic Plan. Consequently, the City believes that the Strategic Plan reflects Edmontonians' desires.

Historically, the City has typically invited feedback and input into the budget as Council is considering its approval, rather than obtaining citizen input into how the budget is developed. At this late stage of the process, consultation may not have much impact on the budget.

To address this inherent process weakness, the Administration, in partnership with the University of Alberta, has engaged a 2009 citizen panel to allow citizens to provide input into the development of budget priorities. City Council will receive the group's recommendations for its consideration prior to giving direction to the Administration to develop the 2010 operating budget.

#### **5.2.5. Provides incentives to government management and employees**

The City's current process does not include incentives for the Administration to develop accurate budget submissions or to manage its budget with a focus on cost-effectiveness.

A publication from The Consortium for Economic Policy Research and Advice provides the following introduction to the topic:

The objective is to help the government make responsible spending decisions by delivering needed programs and services in a way that taxpayers can afford and by meeting required fiscal targets. Service quality, described in service standards, will be key. Prerequisites are a stable environment fiscal and expenditure planning (allowing for changes to spending and programs to be planned well ahead of implementation), strategic planning for the medium- to long-term, and widespread consultations in the expenditure planning process. In addition to the prerequisites, the key is incentives. Incentives encourage effective planning, resource allocation, performance information, and effective management. The secret to success is to design the correct incentive structure, to calibrate incentives in an appropriate way, and to introduce them at the appropriate time when the critical underpinnings are in place.<sup>8</sup>

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<sup>8</sup> Carin, Barry and Good, David; *Public Service Incentives in the Reform of Budgetary Institutions and Enterprises into Autonomous Non-Profit Organizations*; [www.aucc.ca/\\_pdf/english/programs/cepra/Incentivespaper.pdf](http://www.aucc.ca/_pdf/english/programs/cepra/Incentivespaper.pdf)

Creating performance incentives for sound fiscal management in a public body is a sensitive topic. However, rewarding high performance has merit and can result in the ability to attract and retain high-performing management. The key, as stated above, is to have service quality and standards established and stable, with medium to long-term expenditure plans in place, prior to developing a performance incentive program. In our opinion, the City does not have these prerequisites in place and until such time as they are, it should not design or include an incentive program as part of the budget process.

## 6. Conclusion

Both members of City Council and the Administration have expressed their frustration with the City's operating budget process. We focused our review on five themes identified as having the greatest potential to improve the process. Throughout our review, the Administration was actively working on many fronts to improve the process and to engage City Council throughout. Significant to improving the operating budget process, the Administration presented eight budget principles in a motion that City Council approved on March 26, 2009. The application of these principles will be critical. We would expect that adherence to these principles would lead to improved alignment between Council's expectations and the Administration's operating budget submission.

The one area not addressed by the budget principles is the need to centralize the financial stewardship of the city. We directed one recommendation to the City Manager to address this gap. The Chief Financial Officer is positioned to fulfill this role. Members of the Finance and Treasury Department should be engaged in developing the financial impact portion of all Administration reports. The Chief Financial Officer should then approve all Administration reports that have financial implications prior to presenting them to City Council.

In our governance advisory role to City Council, we will continue to monitor the revised operating budget process, and if deemed necessary, include a follow-up review in future City Auditor Work Plans.

### 6.1. Changes to the Budget Process

The Administration and City Council have made progress to plan and initiate the first steps towards improving Edmonton's operating budget process. Improved and more frequent communication between City Council and the Administration is a good first step. The development of budget principles is significant and addresses many of the areas identified by City Council and the Administration at the start of our review. City Council should anticipate the following:

- City Council will be provided better information upon which to make decisions by having all City Council reports with financial implications approved by the Chief Financial Officer.

- Corporate performance reports that include operational and budget performance will be provided regularly to City Council. This will enable corporate performance to be monitored and, where required, adjustments can be made in a timely manner.
- Budget submissions will be supported by annual, validated service level requirements.
- The operating impacts will be presented as part of capital investment proposals and will be once approved will become part of the operating budget submission.
- City Council will discuss priorities and service level expectations in the spring and provide Administration with specific direction upon which a preliminary operating budget can be developed.
- Administration will provide City Council with the resulting preliminary budget results in the fall and confirm that the priorities and service level expectations are aligned with City Council's direction. City Council may provide additional direction at this time so that the final budget submission is aligned with City Council's expectations.

We thank members of City Council and Senior Management Team for providing us with their views and perspectives. We also acknowledge the support of staff from the Finance and Treasury Department as well as the Deputy City Manager's Office.