



Office of the Auditor General/Bureau du vérificateur général

AUDIT OF 2006 AND 2007 COMPENSATION BUDGETS

2007

Chapter 14

VÉRIFICATION DES BUDGETS DE RÉMUNÉRATION

DE 2006 ET 2007

2007

Chapitre 14

Table of Contents

EXECUTIVE SUMMARY	i
RÉSUMÉ	v
1 BACKGROUND.....	1
2 AUDIT OBJECTIVES AND SCOPE.....	1
3 DETAILED OBSERVATIONS	1
4 KEY FINDINGS.....	4
4.1 Budget Process.....	4
4.2 2006/2007 Overstatement of the Benefits Budget.....	4
5 RECOMMENDATIONS AND MANAGEMENT RESPONSES	5
6 CONCLUSION	7
7 ACKNOWLEDGEMENT	8

EXECUTIVE SUMMARY

Introduction

The Audit of the 2006 and 2007 Compensation Budgets was conducted as a result of a report to the Fraud and Waste Hotline. It was not originally identified in the 2007 Audit Plan that was presented to Council.

Audit Objectives and Scope

The scope of this audit was to review the 2006 and 2007 compensation and benefits budgets and to validate and quantify if the base budgets were overstated.

To this end, the audit objectives included an assessment of the completeness and accuracy of the budgets for compensation and benefits and an examination of how budget surpluses were reported to Council.

Summary of Key Findings

Budget Process

1. All approved Full Time Equivalent (FTEs) are included in the compensation budgets. Vacancies are not accounted for, which potentially results in an overstated budget. To some degree this is captured through the vacancy gapping provision defined as savings from vacancies, which was introduced in 2003 as a percentage of compensation costs. In addition there was a temporary gapping program introduced in August 2007 as an interim measure. The overall gapping provision is an arbitrary number, which leaves room for manipulation. There is no evidence that this reflects expected vacancies and timing delays encountered during the hiring process. A budget policy should be developed where a provision for staff vacancies is created in place of gapping. The provision for staff vacancies should be appropriately supported by analysis of approved and vacant FTEs with a calculation of vacancy rates. This provision for vacancies should not be used as a budget pressure or solution but should be identified at the beginning of the budgeting process when the budget is first set prior to any budget adjustments.
2. The budget process and the tools used to create the budgets are manual. The budgets are prepared on multiple Excel spreadsheets outside of SAP and are then entered into SAP. In many cases, variance analysis and forecasting is performed outside of SAP, again on multiple Excel spreadsheets. There are no controls in place in the current planning and budgeting system to ensure proper allocation and reallocation of resources in response to changing priorities and initiatives throughout the year. Consideration should be given to using SAP or other planning tools.

2006/2007 Overstatement of the Benefits Budget

1. The Financial Support Units, in the fall of 2006 and early 2007, calculated the overstatement of the benefits budget and discussions took place at the time on how to account for it. The total overstatement of the benefits budget was \$10 million from which Financial Services deducted \$2 million to cover base compensation shortfalls. This resulted in a net overstatement of benefits budgeted in 2006 of \$8 million.
2. Executive Management Committee (EMC) disclosed the overstatement of benefits as gapping to Council as an option to achieve the 2007 budget target. Correspondence via e-mails indicates that management was aware that the overstatement was in fact related to benefits, not gapping.
3. Council was not made aware of the deliberations around the \$8 million in overstated benefits.
4. During the course of this audit, senior management claimed that the \$8 million only came to light after the 2007 budget was approved. Correspondence amongst Financial Support Units on which the City Treasurer was copied contradicts this claim. Senior management claimed that there was uncertainty around the \$8 million benefits overstatement and that it was carried forward to 2007 in order to conduct a more comprehensive analysis and that it was put in gapping until the analysis could be completed.
5. Before the completion of this audit, in August 2007, a City Treasurer's report to Corporate Services and Economic Development Committee and Council indicated that a more comprehensive analysis revealed an over-allocation to the budget for employee benefits in the amount of \$8.7 million. The City Manager acknowledged at Council the confusion around this issue. The issue being audited has now been rectified.

Recommendations and Management Responses

Recommendation 1

That Financial Services develop a budget policy to create a provision for staff vacancies in place of gapping. This provision for staff vacancies should be identified at the beginning of the budgeting process and should not be used as a budget pressure or solution.

Management Response

Management agrees with this recommendation.

Financial Services will develop a policy by Q4 2008 that will define the corporate direction on the use of gapping for budgeting purposes. The policy will be based on analysis of vacancies and brought to Executive Management Committee for approval. This responds to the intent of the recommendation as "Gapping", by

definition, provides for anticipated vacancies that result from employee turnover throughout the course of a year.

Recommendation 2

That Management ensure that as soon as overstated budgets that are sustainable are identified, that they be adjusted from the base budget and reported to Council.

Management Response

Management agrees with this recommendation.

Financial Services already identifies areas of potential surplus or deficit in the Operating Status Report, which is provided quarterly to Council. In the development of the 2008 draft budgets, staff reviewed their 2007 forecasts, as provided in both the June 30 and September 30, Quarterly Status Reports to assess whether any surplus situations are over provision of budget base requirements or are a one-time occurrence. Where these are deemed to be of a permanent nature, these savings have been identified separately in the 2008 draft budget submissions, under the resource requirements analysis page of each branch submission. Based on these existing practices, no further action is required.

Recommendation 3

That Financial Services review existing controls around the budget process including systems to clearly identify variances to Council.

Management Response

Management agrees with this recommendation.

Financial Services continually reviews and improves both the budget process and reporting mechanisms to Council. The Quarterly Operating Status Report provided to Council shows actual spending and revenues against the amounts budgeted by department and branch and the second and third quarter reports include a forecast of the year-end position by branch. Where these variances are sustainable, the corresponding adjustment to the base budget is identified and reported to Council as part of the draft budget document. As this is an on-going responsibility of Financial Services there is no associated completion date for this recommendation.

Recommendation 4

That Financial Services ensure the variance analysis for compensation and non-compensation line items be segregated on a line basis in order to increase transparency and that surpluses in one area do not offset deficiencies in the other and that the report be provided to Council.

Management Response

Management disagrees with this recommendation.

The Operating Status Report provided to Council on a quarterly basis shows actual spending and revenues against the amounts budgeted by department and branch. The second and third quarter reports include a forecast identifying areas of surplus or deficit that need closer monitoring. In addition, a compensation schedule showing actual salary and benefits along with overtime costs incurred by department and branch is provided.

Non-compensation items are not presented on a line basis in the quarterly status reports. It is the responsibility of the branch directors to ensure effective management and delivery of programs within approved resources and to make decisions that consider the overall effective use of resources for the benefit of the organization. Situations may arise where temporary shortages in available staff resources result in the requirement to deliver a program or service through the use of purchased services, which would be funded by the savings in the compensation budget accounts. Without this latitude to utilize budget funds in this manner, the ability of directors to effectively manage and delivery programs and services would be compromised.

Conclusion

Based on this review, the compensation and benefits budget for 2006 was overstated resulting in an overstatement of the benefits budget that was reported to Council as gapping. The overstatement was also considered in 2007 as a sustainable budget adjustment described as relating to gapping. As part of the June 30, 2007 Operating Budget Status Report, the City Treasurer reported this matter to Council in August 2007 as relating to an over-allocation to the budget for employee benefits and not gapping as was reported earlier in the year. The City Manager acknowledged at Council the confusion around this issue.

Financial Services should change the budget process so that a provision for staff vacancies is identified at the beginning of the budget process. This should be supported by a documented analysis of vacant positions and establishment of a vacancy rate.

Acknowledgement

We wish to express our appreciation for the cooperation and assistance afforded the audit team by management.

RÉSUMÉ

Introduction

La vérification des budgets de rémunération de 2006 et 2007 fait suite à la réception d'un rapport adressé à la Ligne directe fraude et abus et ne figure pas dans le Plan initial de vérification de 2007 soumis au Conseil municipal.

Objectifs et portée de la vérification

La portée de la vérification visait à examiner les budgets de rémunération et des avantages sociaux de 2006 et de 2007 ainsi qu'à déterminer si les budgets de base ont été surestimés et de combien.

À cette fin, la vérification avait notamment pour objectifs d'évaluer l'exhaustivité et l'exactitude des budgets de rémunération et d'avantages sociaux ainsi que d'examiner la façon dont on rend compte des excédents budgétaires au Conseil municipal.

Sommaire des principales constatations

Processus budgétaire

1. Tous les équivalents temps plein (ETP) approuvés sont pris en compte dans les budgets de rémunération, mais non les postes à pourvoir, ce qui peut entraîner une surestimation du budget. Dans une certaine mesure, cette situation s'explique par le « gapping », disposition qui s'applique à l'écart entre le moment où une personne quitte son emploi et celui où elle est remplacée. Instaurée en 2003, cette disposition permet des économies au titre des postes à pourvoir et correspond à un pourcentage des coûts de rémunération. En outre, un programme temporaire de report de la dotation de postes a été introduit en août 2007. La disposition générale sur le « gapping » consiste en un chiffre arbitraire qui laisse place à ces manipulations. Rien ne prouve que cette disposition reflète le nombre de postes à pourvoir et les retards accusés pendant le processus d'embauche. Une politique budgétaire devrait être élaborée, qui comprendrait une disposition à l'égard des postes vacants plutôt que l'utilisation du « gapping ». La disposition traitant des postes vacants devrait être appuyée par l'analyse des ETP des postes vacants approuvés et comprendre le calcul des taux de vacance. Une telle disposition ne devrait pas servir de pression ou de solution budgétaire; elle devrait plutôt être précisée au début du processus budgétaire, plus particulièrement au moment de l'élaboration des prévisions budgétaires et avant tout rajustement budgétaire.
2. Le processus budgétaire et les outils servant à établir les budgets sont manuels. Les budgets sont préparés sur des feuilles de calcul en format Excel avant d'être intégrés au système SAP. Il arrive souvent que des analyses d'écarts et des prévisions soient également effectuées à l'aide de feuilles de calcul, toujours en format Excel, plutôt qu'avec SAP. Dans le système actuel de planification financière et d'établissement

du budget il n'existe aucun moyen de s'assurer de l'attribution et de la réaffectation appropriées des ressources pour répondre aux priorités et aux initiatives changeantes tout au long de l'année. L'utilisation de SAP ou d'autres outils de planification devrait être envisagée.

Surestimation du budget des avantages sociaux de 2006 et de 2007

1. À l'automne de 2006 et au début de 2007, les Unités du soutien financier (USF) ont calculé la surestimation du budget des avantages sociaux, et des discussions ont eu lieu à ce moment-là sur la façon de rendre compte de cette surévaluation. En tout, le budget des avantages sociaux était surévalué de 10 millions de dollars, montant duquel Services financiers a déduit 2 millions pour financer les manques au titre des frais de rémunération de base, ce qui a porté à 8 millions de dollars la surestimation nette prévue en 2006.
2. Le Comité de la haute direction (CHD) a rattaché la surestimation au « gapping », comme moyen de réaliser les objectifs budgétaires de la Ville pour 2007. Selon la correspondance échangée par courriel, la direction savait pertinemment que la surestimation était en fait liée aux avantages sociaux et non au « gapping ».
3. Le Conseil n'a pas été mis au courant des discussions qui ont eu lieu à propos des 8 millions de dollars en avantages sociaux surévalués.
4. Au cours de la vérification, la haute direction a affirmé que les 8 millions n'ont été découverts qu'après l'adoption du budget de 2007. La correspondance entre les membres des USF, envoyée en copie conforme à la trésorière municipale, contredit cette déclaration. La haute direction a soutenu qu'une certaine incertitude entourait la surestimation de 8 millions de dollars du budget des avantages sociaux et que le montant avait été reporté à 2007 pour qu'une analyse plus exhaustive soit menée à cet égard et que la disposition de « gapping » soit appliquée jusqu'à ce que ladite analyse soit achevée.
5. Avant que la présente vérification ne soit terminée, en août 2007, un rapport de la trésorière municipale au Comité des services organisationnels et du développement économique et au Conseil indiquait qu'une analyse exhaustive de la situation a révélé une affectation excédentaire de 8,7 millions de dollars au budget consacré aux régimes d'avantages sociaux. Le directeur municipal a reconnu, devant le Conseil, une certaine confusion autour de cette question. La situation faisant l'objet d'une vérification a été corrigée.

Recommandations et réponse de la direction

Recommandation 1

Que Services financiers élabore une politique budgétaire qui comprenne une disposition sur la création de postes vacants, évitant ainsi le « gapping ». Cette

disposition devrait être établie au début du processus budgétaire et ne devrait pas servir de pression ou de solution budgétaire.

Réponse de la direction

La direction est d'accord avec cette recommandation.

Services financiers élaborera, d'ici le quatrième trimestre de 2008, une politique qui définira l'orientation municipale en ce qui concerne le recours au « gapping » à des fins budgétaires. La politique en question reposera sur l'analyse des vacances de postes et sera soumise à l'approbation du Comité de la haute direction. Cette mesure correspond à l'intention de la recommandation, puisque le « gapping », par définition, détermine le nombre de vacances prévu associé au roulement de personnel au cours d'une année donnée.

Recommandation 2

Que la direction s'assure que les budgets surestimés qui sont jugés durables sont rajustés à partir du budget de base dès qu'ils sont déterminés, puis soumis au Conseil municipal.

Réponse de la direction

La direction est d'accord avec cette recommandation.

Services financiers cerne déjà des secteurs d'excédent ou de déficit potentiels dans le rapport d'étape des dépenses de fonctionnement soumis au Conseil chaque trimestre. Lors de l'élaboration des budgets provisoires de 2008, le personnel a examiné les prévisions de 2007, établies dans les rapports d'étapes trimestriels datés du 30 juin et du 30 septembre, pour déterminer si les cas d'excédent constituent des surprovisions aux exigences de base du budget ou s'ils sont ponctuels. Lorsque ces situations sont jugées permanentes, les économies qui en découlent ont été inscrites séparément dans les budgets provisoires de 2008, à la page consacrée à l'analyse des exigences en matière de ressources des budgets soumis par chaque direction. Compte tenu des pratiques actuelles, aucune autre mesure ne sera nécessaire.

Recommandation 3

Que Services financiers examine les mesures de contrôle en place dans le processus budgétaire, y compris les systèmes permettant d'indiquer clairement les écarts à l'intention du Conseil.

Réponse de la direction

La direction est d'accord avec cette recommandation.

Services financiers revoit et améliore continuellement le processus budgétaire et les mécanismes de production de rapports au Conseil. Le rapport d'étape trimestriel consacré au fonctionnement qui est soumis au Conseil présente les dépenses et les recettes réelles en comparaison avec les sommes prévues dans le budget par service

et par direction, et les rapports des deuxième et troisième trimestres comprennent pour chaque direction des prévisions sur la situation à la fin de l'exercice. Lorsque les écarts sont durables, les rajustements correspondants apportés au budget de base sont déterminés et soumis au Conseil par l'entremise du document des budgets provisoires. Comme il s'agit d'une responsabilité permanente de Services financiers, aucune date d'achèvement n'est associée à l'application de cette recommandation.

Recommandation 4

Que Services financiers s'assure que l'analyse des écarts relatifs aux postes budgétaires liés à la rémunération et aux postes qui n'y sont pas liés est divisée selon les postes budgétaires afin d'accroître la transparence du processus; que les excédents enregistrés dans un secteur ne servent pas à compenser les déficits dans d'autres secteurs; et que le rapport soit soumis au Conseil.

Réponse de la direction

La direction n'est pas d'accord avec cette recommandation.

Le rapport d'étape consacré au fonctionnement et remis au Conseil trimestriellement présente une comparaison des dépenses et des recettes réelles, par rapport aux sommes prévues au budget de chaque service et direction. Les rapports des deuxième et troisième trimestres comprennent des prévisions des secteurs qui ont enregistré un excédent ou un déficit et qui doivent être surveillés de plus près. En outre, un tableau montrant les salaires et les avantages sociaux réels ainsi que le coût des heures supplémentaires engagées par chaque service et direction est fourni.

Les postes non liés à la rémunération ne sont pas divisés linéairement dans les rapports d'étape trimestriels. Il incombe aux directeurs d'assurer une gestion et une prestation efficaces des programmes en fonction des ressources approuvées et de tenir compte, pour la prise de décision, de la nécessité d'utiliser efficacement les ressources dans l'intérêt de l'ensemble de l'organisation. Par ailleurs, il est possible que des pénuries temporaires de main-d'œuvre disponible nécessitent le recours à l'achat de services pour offrir un programme ou un service, qui serait financé au moyen des économies réalisées au titre de la rémunération. Si les directeurs n'avaient plus la latitude voulue pour utiliser les crédits budgétaires de cette façon, leur capacité à gérer efficacement la prestation de programmes et de services serait compromise.

Conclusion

La présente vérification a révélé une surestimation du budget de 2006 consacré à la rémunération et aux avantages sociaux, ce qui a donné lieu à la soumission au Conseil d'un budget surévalué attribuable au « gapping ». En 2007, la surestimation a été considérée comme un rajustement budgétaire durable et associée au « gapping ». Dans le cadre de son rapport d'étape trimestriel du 30 juin 2007 portant sur le budget de fonctionnement, la trésorière municipale a signalé au Conseil, en août 2007, que les

fonds excédentaires étaient liés au budget des avantages sociaux des employés et non au « gapping » comme il avait été indiqué plus tôt dans l'année. Le directeur municipal a reconnu, devant le Conseil, la confusion existant autour de cette question.

Services financiers devrait changer son processus budgétaire de sorte qu'il comprenne une disposition sur les postes vacants, qui serait déterminée au début du processus. De plus, cette étape devrait être appuyée par une analyse documentée des postes vacants et l'établissement d'un taux de vacance.

Remerciements

Nous tenons à remercier la direction de sa bienveillante collaboration et de l'aide qu'elle a apportée à l'équipe de vérification.

1 BACKGROUND

The Audit of the 2006 and 2007 Compensation Budgets was conducted as a result of a report to the Fraud and Waste Hotline. It was not originally identified in the 2007 Audit Plan that was presented to Council.

2 AUDIT OBJECTIVES AND SCOPE

Audit Objectives and Scope

The scope of this audit was to review the 2006 and 2007 compensation and benefits budgets and to validate and quantify if the base budgets were overstated.

To this end, the audit objectives included an assessment of the completeness and accuracy of the budgets for compensation and benefits and an examination of how budget surpluses were reported to Council.

3 DETAILED OBSERVATIONS

3.1 Budget Process

A review of the budget process for compensation and benefits revealed that a formal process is in place. A detailed budget schedule is prepared by Financial Planning and distributed to the branches. The branches are instructed to budget for the operating needs of the upcoming year based on the “anticipated contract increases” approved by Council. The budget preparation is coordinated by the Financial Support Units who are intimately involved through the entire process. The branches are responsible for the content of their budgets but work closely with their respective Financial Support Unit to compile budgets that accurately reflect operational needs and resource allocations. According to the Financial Support Units, they play a challenge role with the branches in the sense that they discuss and question budget assumptions and how to deal with the “wish list” as opposed to what will realistically be approved. Departmental management committees and the Executive Management Committee (EMC) also have a challenge role.

The Financial Support Units provided documentation that supported the budgeted compensation and benefits budgets. Compensation budgets are compiled on Excel spreadsheets: actual rates from the payroll system are used to calculate the budget for all approved Full Time Equivalents (FTEs) including vacant positions, which are mostly budgeted at the mid range. Benefits are calculated based on Employee Services’ “best estimate” of final negotiated rates for the upcoming year. New rates are applied each budget year. The approval process for the final budget goes through much iteration amongst the branches, the Financial Support Units, departmental management committees, and EMC before final approval and submission to Council.

The budget includes the full-approved FTE complement including any vacant positions. An allowance for vacancies is not calculated which potentially results in an overstated budget for compensation. From discussions with selected Financial Support Units, there is a belief that the gapping provision (a provision to address vacancies and timing differences) as it exists deals with the vacancy issue. However, they concurred that the gapping provision is arbitrary and is not linked back to expected vacancies. There is no evidence to support the accuracy of the gapping provision.

Benchmarking on how other municipalities handle the issue of vacancies and staffing timing differences shows that the City of Toronto¹ uses gapping which they define as “savings in the funding requirement for salaries and benefits realized as a result of (a) vacancies not intended to be filled for a full or part year (known gapping) and (b) unplanned or unanticipated staff turnover (unknown gapping)”. Their gapping rate is based on experience and is dependent on a program’s specific workforce profile. For 2007, their gapping analysis shows the average gapping rate was 1.8% of their total salary and benefits budget. However, individual rates vary from one department program to another (0 to 4.5%). Proposed changes to the gapping rates are considered a service impact and treated as a new/enhanced change in the operating budget. The City of Gatineau centrally manages the impact of vacancies on its operating budget. Although the models differ, they both provide greater transparency and precision with respect to the impact of vacancies.

As indicated in the Operating Status Report for June 30, 2007, presented by the City Treasurer to Corporate Services and Economic Development Committee and Council, there is a move to greater transparency in the compensation and benefits budgets. A “temporary” gapping program was implemented to recognize time lags in staffing new positions that are budgeted for a full year. In addition, Council adopted a motion that for the remainder of 2007, the Operating Status and Forecast Report provide City Council with a detailed accounting of compensation, including actual allocations for overtime, salary and benefits.

A budget policy should be developed where a provision for staff vacancies is created in place of gapping. This provision for vacancies should be appropriately supported by documentation of approved and vacant FTEs with a calculation of vacancy rates. This provision for vacancies should not be used as a budget pressure or solution, but should be identified at the beginning of the budgeting process when the budget is first set prior to any budget adjustments.

Though a budgeting process for compensation and benefits is in place, it is manual. The budgets are compiled on multiple spreadsheets and not using SAP, the corporate

¹ City of Toronto, 2007 Budget Briefing Note, 2007 Staff Recommended Gapping

financial system. There is no integration between systems, within branches or between branches. This poses an inherent weakness in the system.

The Financial Support Units provide the branches with monthly reports from SAP for analysis of budget vs. actual. The forecasting exercise takes place using spreadsheets and extracting information from SAP. Forecasts and projections are prepared twice a year at the end of the second and third quarters. A status report is prepared and presented to Council.

It should be noted that a more robust and dynamic planning tool may have highlighted the discrepancy in the benefits sooner and this would have enabled management to respond in a proactive and more timely fashion. Consideration should be given to using SAP or other planning tools.

3.2 2006/2007 Overstatement of the Benefits Budget

The benefits budget in 2006 was in fact overstated. The Financial Support Units, in the fall of 2006 and early 2007, calculated the overstatement of the benefits budget and discussions took place at the time on how to account for it. This revealed the total overstatement of the benefits budget was \$10 million from which Financial Services deducted \$2 million to cover other base compensation shortfalls. This resulted in an overstatement of benefits budgeted in 2006 by a net of \$8 million. At this point a decision was not taken on how to deal with the overstatement but it is clear that, coincidentally, there was additional pressure to cut costs for the 2007 budget.

During the course of this audit, it was clear that many of the Financial Support Units were aware of the overstatement in benefits as they had done the calculations and provided them to management. In their view, senior management was also aware that the \$8 million overstatement was in fact an overstatement in benefits and not additional gapping. They were unaware of what meetings took place and expressed confusion about what lead EMC to classify the \$8 million as gapping and report it as such to Council.

As reported by the City Treasurer, the \$8 million in overstated benefits was included in the \$23.5 million 2006 surplus that Council authorized be applied to reduce the 2007 tax requirement (February 19, 2007). In addition to this, the \$8 million in overstated benefits was also included in the \$29.750 million identified sustainable budget reductions for 2007 presented to Council and approved.

On August 27, 2007 before the completion of this audit, the City Treasurer provided an Operating Status Report to Corporate Services and Economic Development Committee with an update that compensation budgets had been realigned. This report indicated that in total \$8.7 million for benefits has been eliminated and the gapping reduced by an equivalent amount. The City Manager acknowledged at Council on August 29, the

confusion around this issue. The issue has now been rectified. As at September 5, 2007 the budget adjustment was in the process of being prepared and had not been reviewed by the auditor.

4 KEY FINDINGS

4.1 Budget Process

1. All approved FTEs are included in the compensation budgets. Vacancies are not accounted for which potentially results in an overstated budget. To some degree this is captured through the vacancy gapping provision defined as savings from vacancies which was introduced in 2003 as a percentage of compensation costs. In addition there was a temporary gapping program introduced in August 2007 as an interim measure. The overall gapping provision is an arbitrary number which leaves room for manipulation. There is no evidence that this reflects expected vacancies and timing delays encountered during the hiring process. A budget policy should be developed where a provision for staff vacancies is created in place of gapping. The provision for staff vacancies should be appropriately supported by analysis of approved and vacant FTEs with a calculation of vacancy rates. This provision for vacancies should not be used as a budget pressure or solution but should be identified at the beginning of the budgeting process when the budget is first set prior to any budget adjustments.
2. The budget process and the tools used to create the budgets are manual. The budgets are prepared on multiple Excel spreadsheets outside of SAP and are then entered into SAP. In many cases, variance analysis and forecasting is performed outside of SAP, again on multiple Excel spreadsheets. There are no controls in place in the current planning and budgeting system to ensure proper allocation and reallocation of resources in response to changing priorities and initiatives throughout the year. Consideration should be given to using SAP or other planning tools.

4.2 2006/2007 Overstatement of the Benefits Budget

1. The Financial Support Units, in the fall of 2006 and early 2007, calculated the overstatement of the benefits budget and discussions took place at the time on how to account for it. The total overstatement of the benefits budget was \$10 million from which Financial Services deducted \$2 million to cover other base compensation shortfalls. This resulted in a net overstatement of benefits budgeted in 2006 of \$8 million.
2. EMC disclosed the benefits overstatement as gapping to Council as an option to achieve the 2007 budget target. Correspondence via e-mails indicates that management was aware that the overstatement was in fact related to benefits, not gapping. Correspondence also indicates that the \$8 million was earmarked as a

possible solution within the overall strategy to meet the zero base tax increase mandate (there was pressure to achieve the zero base increase in the tax base for 2007 while addressing 2007 budget pressures).

3. The City ended the year with a \$23.5 million surplus that Council approved as a transfer to the Tax Stabilization Reserve to help achieve the zero base tax increase for 2007. Though not specifically identified in the variance analysis, the \$8 million in benefits overstatement is included in the \$23.5 million surplus.
4. For the 2007 budget staff provided Council with another \$29.750 million in sustainable budget reductions. The \$8 million benefits overstatement was included here as well as gapping. The rationale for this is unclear though it appears to have been an option that allowed EMC some flexibility in 2007. The impact is that without this \$8 million gapping, EMC would have had to come up with an additional savings of \$8 million to achieve its mandate.
5. Council was not made aware of the deliberations around the \$8 million in overstatement benefits.
6. During the course of this audit, senior management claimed that the \$8 million only came to light after the 2007 budget was approved. Correspondence amongst Financial Support Units on which the City Treasurer was copied contradicts this claim. Senior management claimed that there was uncertainty around the \$8 million benefits overstatement and that it was carried forward to 2007 in order to conduct a more comprehensive analysis and that it was put in gapping until the analysis could be completed.
7. Before the completion of this audit, in August 2007, the City Treasurer provided an Operating Status Report to Corporate Services and Economic Development Committee with an update that compensation budgets had been realigned. The City Treasurer's report indicated that in total \$8.7 million for benefits has been eliminated and the gapping reduced by an equivalent amount.
8. The City Manager acknowledged at Council in August 2007 the confusion around this issue. The issue being audited has now been rectified. As at September 5, 2007 the budget adjustment was in the process of being prepared and had not been reviewed by the auditor.

5 RECOMMENDATIONS AND MANAGEMENT RESPONSES

Recommendation 1

That Financial Services develop a budget policy to create a provision for staff vacancies in place of gapping. This provision for staff vacancies should be identified at the beginning of the budgeting process and should not be used as a budget pressure or solution.

Management Response

Management agrees with this recommendation.

Financial Services will develop a policy by Q4 2008 that will define the corporate direction on the use of gapping for budgeting purposes. The policy will be based on analysis of vacancies and brought to Executive Management Committee for approval. This responds to the intent of the recommendation as “Gapping”, by definition, provides for anticipated vacancies that result from employee turnover throughout the course of a year.

Recommendation 2

That Management ensure that as soon as overstated budgets that are sustainable are identified, that they be adjusted from the base budget and reported to Council.

Management Response

Management agrees with this recommendation.

Financial Services already identifies areas of potential surplus or deficit in the Operating Status Report, which is provided quarterly to Council. In the development of the 2008 draft budgets, staff reviewed their 2007 forecasts, as provided in both the June 30 and September 30, Quarterly Status Reports to assess whether any surplus situations are over provision of budget base requirements or are a one-time occurrence. Where these are deemed to be of a permanent nature, these savings have been identified separately in the 2008 draft budget submissions, under the resource requirements analysis page of each branch submission. Based on these existing practices, no further action is required.

Recommendation 3

That Financial Services review existing controls around the budget process including systems to clearly identify variances to Council.

Management Response

Management agrees with this recommendation.

Financial Services continually reviews and improves both the budget process and reporting mechanisms to Council. The Quarterly Operating Status Report provided to Council shows actual spending and revenues against the amounts budgeted by department and branch and the second and third quarter reports include a forecast of the year-end position by branch. Where these variances are sustainable, the corresponding adjustment to the base budget is identified and reported to Council as part of the draft budget document. As this is an on-going responsibility of Financial Services there is no associated completion date for this recommendation.

Recommendation 4

That Financial Services ensure the variance analysis for compensation and non-compensation line items be segregated on a line basis in order to increase transparency and that surpluses in one area do not offset deficiencies in the other and that the report be provided to Council.

Management Response

Management disagrees with this recommendation.

The Operating Status Report provided to Council on a quarterly basis shows actual spending and revenues against the amounts budgeted by department and branch. The second and third quarter reports include a forecast identifying areas of surplus or deficit that need closer monitoring. In addition, a compensation schedule showing actual salary and benefits along with overtime costs incurred by department and branch is provided.

Non-compensation items are not presented on a line basis in the quarterly status reports. It is the responsibility of the branch directors to ensure effective management and delivery of programs within approved resources and to make decisions that consider the overall effective use of resources for the benefit of the organization. Situations may arise where temporary shortages in available staff resources result in the requirement to deliver a program or service through the use of purchased services, which would be funded by the savings in the compensation budget accounts. Without this latitude to utilize budget funds in this manner, the ability of directors to effectively manage and delivery programs and services would be compromised.

6 CONCLUSION

Based on this review, the compensation and benefits budget for 2006 was overstated resulting in an overstatement of the benefits budget that was reported to Council as gapping. The overstatement was also considered in 2007 as a sustainable budget adjustment described as relating to gapping. As part of the June 30, 2007 Operating Budget Status Report, the City Treasurer reported this matter to Council in August 2007 as relating to an over-allocation to the budget for employee benefits and not gapping as was reported earlier in the year. The City Manager acknowledged at Council the confusion around this issue.

Financial Services should change the budget process so that a provision for staff vacancies is identified at the beginning of the budget process. This should be supported by a documented analysis of vacant positions and establishment of a vacancy rate.

7 ACKNOWLEDGEMENT

We wish to express our appreciation for the cooperation and assistance afforded the audit team by management.