



STAFF REPORT ACTION REQUIRED

Budgetary and Financial Management Approval Process and Protocols for the TTC

Date:	August 5, 2010
To:	Executive Committee
From:	City Manager and Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	

SUMMARY

This report responds to Council's July 2010 request for a report to clarify in-year spending and reporting approval protocols for the Toronto Transit Commission (TTC). In developing this protocol, staff also considered Council's request for the TTC to comply with the City's budget submission requirements as outlined in Recommendation 98 of the April 15, 2010 budget approval report.

Historically the TTC had been able to rely almost entirely on fares to fund its operating costs, or on stable subsidies from the City and the Province. In the absence of a stable provincial operating subsidy, the TTC has become dependent on the City to maintain required service levels. Given the extent and growth of the City's funding over time, it is appropriate now to establish a more integrated relationship with the City's financial planning and management framework.

This report clarifies the City's authority respecting the TTC's budgetary and financial management policies and processes and sets out the protocol for TTC budget approvals and in-year budget adjustments reflecting current City financial and budget policy and procedures. Legislation permits the City to prescribe by by-law the budget submission process and determine what City approvals the TTC must seek in managing its spending throughout the year and in dealing with year-end surpluses and shortfalls.

Given the significant size and scope of the TTC Capital and Operating budgets and to ensure consistency with Council budgetary policy and procedures, this report recommends that Council approve this direction to the TTC. City and TTC staff will then

work together to implement the Council directions related to the Corporate budgetary process and protocols as part of the 2011 budget process.

RECOMMENDATIONS

The City Manager and Deputy City Manager and Chief Financial Officer recommend that:

1. Council require the Toronto Transit Commission (TTC) to comply with the following:
 - (a) that the TTC submit budget requests in accordance with the City of Toronto's *Capital Budget and Plan Submission Guidelines and Instructions* and *Operating Budget Submission, Guidelines and Instructions* manuals, and in accordance with budget targets as established by City Council and timelines as determined by the Deputy City Manager and Chief Financial Officer from time to time;
 - (b) that the City's policies and practices as outlined in Attachment 1 apply to the TTC for all budget approvals, in-year budget adjustments, variance reports, and surplus dispositions; and
2. Council authorize the City Solicitor to introduce the necessary by-law for enactment by Council implementing the requirements set out in Recommendation (1) utilizing the City's powers under the *City of Toronto Act, 2006* respecting the financial management of the City's local boards, including their financial relationship, budget submission requirements and adherence to City budget policies and procedures.

Financial Impact

Approval of these recommendations will have no direct financial impact. However, given that TTC capital budget reflects about one half of the tax supported capital budget and is the largest operating budget for the City, it is necessary to ensure consistent budgetary accountability for all City funded programs.

These recommendations will enable the City to improve its due diligence review of TTC budget submissions and will provide sufficient time to review, assess and make recommendations on the TTC 10-year capital plan and operating budget submissions.

The recommended in-year financial management and approval process and protocols will provide the TTC with a clear understanding of its financial accountabilities to the City in relation to the City's financial management, control and reporting practices, enabling the City to better assess the financial impacts of any potential in-year budgetary changes within its fiscal affordability and financial accountability frameworks.

DECISION HISTORY

On April 15, 2010, Council approved Recommendation 98 in the 2010 Approved Operating Budget that stated:

"City Council request the Toronto Transit Commission to direct the Chief General Manager of the Toronto Transit Commission to ensure that all future budget submissions are in accordance with City of Toronto budget submission requirements that include compliance with all City financial/budgetary policies and provision of complete, detailed budget information in the format and standards set out by the City, to be made available within the timelines of the budget process review schedule, as assigned by the Financial Planning Division, to ensure appropriate time to review, assess and make recommendations and consolidate within the City of Toronto's financial and budgeting systems."

At its July 7, 8, and 9, 2010 meeting, Council considered report EX 45.32 entitled "2010 TTC Budget Update" recommending various in-year service changes to be funded by additional fare revenue resulting from higher than budgeted ridership. Council directed that all potential year-end surplus be treated in accordance with the City's year-end practices and surplus management policy. Council also approved the following Executive Committee recommendation:

"City Council request the City Manager and the Deputy City Manager and Chief Financial Officer, in consultation with the TTC's Chief General Manager, to report to Executive Committee, as soon as possible, to clarify in-year spending and reporting approval protocols."

This report responds to Council's direction to report on the protocols that apply to the TTC.

ISSUE BACKGROUND

Over time, the City has gained a higher degree of authority over the governance of the TTC, as well as other city boards. For example, in 1996, the Province provided municipalities a degree of control through Regulation 214/96 made under the former Municipal Act that permitted municipalities to change the governance structure and to impose policies and budget requirements. In 2006, *City of Toronto Act, 2006* (COTA) gave the City control, with some minor limitations, over the governance structure of the TTC and other city boards, along with the authority to create, change or dissolve these boards and to direct that certain policies be implemented.

With respect to financial matters, the City may enact by-laws governing the following:

- The requirement that the board follow rules, procedures and policies established by the City.
- The relationship between the City and the board, including their financial and reporting relationship.

- Any procedural requirements, including conditions, approvals and appeals which apply to the delegated powers of the board.

The COTA also details the obligations of the City in the adoption of a yearly budget, including amounts required for any board or commission. COTA details basic rules imposed on the City as to what is to be set out in the budget and the treatment of revenues, expenses and surplus. In recognition of the obligations on the City, COTA also provides that the City may by by-law require that the budget of every board, commission or other body (other than a school board) for which the City is required by law to levy a tax or provide money, be submitted to the City on or before a date specified by the City and that the budget be in such detail and form as the by-law provides.

Budget Committee members and TTC Commissioners have discussed the application of the City's budgetary and financial policies and processes related to the TTC. The recommendations of the Budget Committee and subsequent Council directions reflect these discussions.

It is important that the City and the TTC, as a city board, clearly understand their respective roles (including authority and accountability) in financial planning and budget management and that the financial management relationship be clearly and publicly documented. Consequently, it is necessary to codify the responsibilities of the TTC in relation to budgetary matters in a City by-law.

COMMENTS

City's Financial Planning and Management Framework

The City's financial planning and management framework is comprised of five key components:

- Capital and Operating budget planning, preparation and submissions
- Budget review and approvals
- In-year financial control and budget adjustments
- Financial monitoring and variance reporting
- Year-end financial performance and disposition of year-end surplus or deficit (actual net expenditures less than or in excess of the budgeted City funding).

A description of the budget submission and approval process and in-year financial monitoring, control, and adjustment processes is outlined in Attachment 2 to this report.

Budget Process & Timelines

In the case of ABCs, formal budget submissions must first be approved by the Board. Board approval is required in advance of the dates established for the public launch of the City's capital plan and operating budgets that then receive formal consideration by the City Budget Committee, Executive Committee and Council.

The City has requested TTC staff to schedule special meetings of the Commission to coincide with City budget timelines, to enable both City staff and Budget Committee members to have final, formal submissions for their review and consideration. TTC staff have agreed to comply with the City's information requirements and schedule starting with the 2011 capital budget process.

Capital Budget and Plan

The City's Capital Plan consists of many projects from all City Programs and ABCs to be carried out over a ten year horizon. Each project is prioritized according to the City's policy objectives. The Capital Plan ultimately determines how much debt the City will be expected to issue in each year and what level of property tax is required to repay the debt issued.

With limited City financial resources each project must be screened for need, appropriate cost estimates assigned to the projects and secure funding sources identified for each project. The progress of the capital plan must be carefully monitored in detail to ensure that it continues to be affordable.

The TTC's 10 Year Capital Budget and Plan submission includes gross expenditures for each project in each of the 10 years, but does not assign funding source by project. In order to expedite provision of capital details, the TTC has agreed to review Toronto Water's capital budget process which has a capital budget of similar size and complexity to ensure funding by project.

Any changes to the Capital Budget and Plan must be reported and approved by Council, to ensure compliance with the City's Financial Control By-Law. All City Programs and ABCs must adhere to this financial control policy and the reporting and approval process to seek Council approval through Committee for in-year adjustments to their Capital Budget and Plan.

Furthermore, COTA requires that any TTC acquisitions which are to be funded by debt issued by the city, must receive Council's consent.

While the TTC does report significant changes to its Capital Budget to the City, it has often been a challenge to find specific project offsets for proposed increases and to assess the debt impact of these according to funding sources for each capital project. Given the size of the TTC's Capital Budget and Plan and the size of their individual projects, project and funding offsets for project overspending must be explicitly identified and reported for approval to Committee and Council.

Operating Budget

It is proposed that the TTC be required to comply with submission requirements as do all other City programs and ABCs as outlined in the *Capital Budget and Plan Submission*

Guidelines and Instructions and Operating Budget Submission, Guidelines and Instructions manuals.

In approving the annual Operating Budget for each City Program and ABC, Council explicitly approves:

- total gross expenditures required to fund the total cost of providing the services, service levels and staff complement as reflected in the Operating Budget;
- total revenue as summed by the individual non-tax revenue sources; and
- the resultant, net expenditures that determine the level of residual tax-supported (or rate-supported) funding required to balance the Operating Budget for each City Program/ABC and in whole.

Any adjustments to the above amend the City's budget and must be approved by Council.

All City Divisions and ABCs monitor budget performance throughout the year and are required to submit variance reports on a quarterly basis. As part of the City's financial management and accountability framework, the Deputy City Manager and Chief Financial Officer reports quarterly to Committee and Council to provide year to date and projected year-end spending and revenue performance, to identify any issues and provide mitigation strategies, and, if required, recommend approval of any budget adjustments to the Capital and Operating Budgets.

For the Operating Budget, Council approves the gross expenditure, total revenue and net expenditure (tax or rate supported funding). Any adjustment in-year to any of these requires Council approval.

In cases where service levels are subject to external customer demand such as ridership on the TTC, if demand is higher than expected, additional staffing and resources may be required to accommodate the added demand. Usually there is a corresponding increase in revenue to accommodate the additional resources but they may not be enough to cover the added cost or sustain the added costs over time. As a result, City Programs and ABCs are required to report the expenditure and revenue impacts of these added demands to Committee and Council for approval in order to amend their operating budgets.

The timing of the TTC's monthly reports to the Commission should be adjusted to reflect the requirements of the City's variance reporting schedule.

Surplus Management

The year-end variance reporting process requires all City Programs and ABCs to identify and explain their respective year end surplus or deficit position. Deficits are funded by the City and all surplus funds are payable to the City. The Deputy City Manager and Chief Financial Officer recommends to Council the disposition of these funds as per the City's Surplus Management Policy. The use of surplus funds is not within the purview of individual City Program staff or ABCs.

As an example, for 2010, the TTC has forecast increased ridership over budget resulting in significant added revenues. Approval by Council was given to allocate a portion of the increased revenues to add buses and staff to existing routes to maintain service levels with respect to crowding. However, the requests to add new routes and decrease wait times was referred to the 2011 budget process as a change in the service. This allows for the review of these new service requests against all others in the context of the City's overall financial position forecasted for 2011.

By-Law Regarding TTC Budget Approval Protocols

As a city board, the TTC is subject to the same budget policies and processes as all other City programs and ABCs. Council has indicated its requirement for the TTC to adhere to all of the budget submission requirements as outlined in the *Capital Budget and Plan Submission Guidelines and Instructions* and *Operating Budget Submission, Guidelines and Instructions* manuals. In addition, the TTC is also subject to the same monitoring and review processes during the year and in-year variance reporting and budget adjustment approvals are required. These requirements are outlined in Attachment 1 to this report.

In accordance with legislation, Council provides direction to the TTC in this regard through a City by-law. It is recommended that Council enact a by-law governing these budget approval protocols for the TTC in order to ensure that it is clear that these apply to the TTC.

Relationship Framework

The City Manager's Office has been developing relationship frameworks for all City ABCs and shareholder directions for City corporations. These documents cover many topics such as the mandate, legislative authority of the body, its role and responsibilities, its accountability to the City, corporate policies that apply to it, board composition, financial reporting relationships, audit rights, and some administrative practices. Each relationship framework is unique to the form and role of the ABC.

It is important that the City and the TTC, as a city board, clearly understand the mandate, role, authority and accountability of the TTC and that it be clearly and publicly documented as City policy. The City Manager, in conjunction with the Chief General Manager of the TTC, will be developing a relationship framework and accompanying City by-law covering the governance of the TTC for consideration by the new Council in 2011.

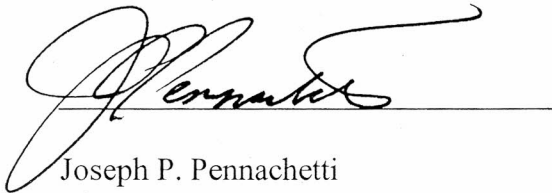
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ATTACHMENTS

- Attachment 1 – Budgetary and Financial Management Approval Process and Protocols for the Toronto Transit Commission (TTC)
- Attachment 2 – City's Financial Planning and Management Framework as Applied to the TTC

ATTACHMENT 1

Budgetary and Financial Management Approval Process and Protocols for the Toronto Transit Commission (TTC)

1. Council Approval of the Budget

10-Year Capital Budget and Plan:

Council approves:

- a) a Capital Budget for the current year consisting of :
 - approved gross expenditures (cashflow) and funding for previously approved projects/sub-projects;
 - the total project cost and appropriated gross expenditures (cashflow) and funding for new and change in scope capital projects/sub-projects as well as commitments to future year gross expenditures (cashflow) and funding for multi-year projects
 - unspent funding carried forward from prior years to complete projects
- b) planned estimates and funding sources for each capital project/sub-project for the balance of the 10 years.
- c) debt funding for each of the 10 years (debt issued only for the current budget year).

Operating Budget:

Council approves:

- a) total gross expenditures required to fund the total cost of providing the services, service levels and staff complement as reflective in the Operating Budget;
- b) total revenue as summed by the individual non-tax revenue sources; and
- c) the resultant, net expenditures that result in the level of residual tax-supported (or rate-supported) funding required to balance the Operating Budget.

2. Council Approval of In-Year Budget Adjustments

Given that Council approval of the Capital and Operating Budgets is based on the information set out above, further Council approval shall be required for any of the following changes to the TTC's Council-approved Capital Budget and Plan and Operating Budget within the year for which the budgets are approved:

Capital Budget and Plan

Any changes to the approved capital budget and plan as a result of:

- a) over-expenditures
- b) accelerations
- c) deferrals
- d) change in project scope greater than 10% of the project cost or \$500,000

- e) the addition of a new project
- f) unplanned allocations of funding sources including reserve funds

Changes must result in a permanent reallocation of funding from other projects with like funding sources in the current year (with appropriate adjustments to these projects) and any future year projects in the 10 –Year Capital Plan.

Funding must be in place to award contracts.

Operating Budget

Any changes to the Operating Budget that result in changes to any of the following: gross expenditures, total revenue, and/or net expenditures (tax supported funding) as well as the City's overall staff complement count, including any proposed changes to services or service levels, as these amend the gross expenditures and revenue sources, regardless of the funding source.

3. Variance Reporting:

The TTC shall submit quarterly variance reports according to the reporting periods and submission timelines set out by the Director, Financial Planning, providing the City with information pertaining to year-to-date actual expenditures, projected year-end expenditures and budget variance with a narrative explanation of significant variances and any mitigation strategies for its services for Operating Budget variance reporting, and by capital project for Capital Budget variance reporting.

The TTC shall also request Council, through the quarterly variance report, to close projects which are completed or to partially close on-going projects for which unspent project costs from previous years are no longer required.

4. Surplus

If the TTC generates a surplus in excess of its budgeted net expenditures, it is payable to the City. The Deputy City Manager and Chief Financial Officer will determine the disposition of these funds. These settlements are approved by Council.

City's Financial Planning and Management Framework as Applied to the TTC

The City's financial planning and management framework is comprised of five key components:

- Capital and Operating budget planning, preparation and submissions
- Budget review and approvals
- In-year financial control and budget adjustments
- Financial monitoring and variance reporting
- Year-end financial performance and disposition of year-end surplus or deficit (actual net expenditures less than or in excess of the budgeted City funding).

Budget Planning, Preparation and Submission

The 10 Year Capital Plan and the Operating Budget are to be prepared and submitted to the Financial Planning Division on an annual basis in adherence to budgetary policies, guidelines, information and budget system requirements as set out in the annual Manuals of Instruction – *the Capital Budget and Plan Submission, Guidelines and Instructions* and the annual *Operating Budget Submission, Guidelines and Instructions* and in accordance with budget targets approved by Council and timelines as set out by the Deputy City Manager and Chief Financial Officer.

Capital Budget Preparation and Monitoring Protocol

Preparation

The City's Capital Plan consists of a collection of projects under various programs to be carried out over a ten year horizon. The projects included in the plan are prioritized and placed within the ten year planning period on the basis of a number of factors including:

- State of good repair
- Health and Safety
- Program growth requirements
- Readiness to proceed
- Ability to spend
- Logical construction staging
- Sources of funding and timing of the funding

The capital plan ultimately determines how much debt the City will be expected to issue in each year and what level of property tax is required to repay the debt issued. The City's debt repayment policy limits are projected to be reached by 2014. Therefore, the progress of the capital plan must be carefully monitored to ensure that it continues to be affordable.

Accordingly, the key requirements to update the capital plan on an annual basis include, but are not limited to the following:

- ✓ Capital projects/sub-projects must be eligible capital expenditures
- ✓ Business cases must be submitted in CAPTOR (City Corporate Budgetary system) that describe each capital project for each year of 10 years and identifies:
 - Gross expenditures and financing sources for each capital project/sub-project for 10 years
 - Total project cost, current year cashflow estimate and commitments for future year cashflow (where the project is multi-year)
 - Project completion date
 - Project status (eg. previously approved, change in scope, new) and project category (eg. Health and safety, state of good repair, growth)
 - Projected actual expenditures to year-end and requests to carry forward funding of unspent funds to complete projects
 - Completed projects that may be closed
 - Operating impacts from completed capital projects

Monitoring

Once the capital plan is approved, the actual progress of each project is to be tracked. Some projects will be completed under budget while others will require further funding. Other projects may be delayed and others will need to be accelerated. Some projects may be cancelled and new priority projects may be added within the year of budget approval.

It is not only the project costs that can change. Funding sources or the amount of the expected funding can change as well. If third party capital funding is confirmed to be less than expected, Provincial/Federal funding, reserve draws, debt financing or current operating budget contributions to capital may be called upon to fill the funding gap.

To monitor the capital plan, all City Programs and ABCs are required to report quarterly on the progress of their Capital Budget and Plan. If cost overruns are expected on a particular project, the City Program or ABC is expected to find offsetting permanent cost savings in other projects undertaken in the same year. If this cannot be accomplished, an offsetting project may be delayed to a later year in the plan. If this occurs, future projects will have to be repositioned to accommodate the delay within the approved funding established for each year in the plan. This repositioning of projects occurs when the capital plan is updated on an annual basis.

Programs that do not complete projects approved in their capital budget within the current year are allowed, within certain time limits, to carry forward unused spending into the following year to complete those projects. This "carry forward" funding is generally added to the first year of the updated capital plan the following year.

It is important to note that the funding available through operating budget capital contributions and debt issuance in the current year, once established in the capital plan, is not increased during the year. Programs are not authorized to "borrow" (i.e. accelerate) debt financing from a future year in their capital plan.

Programs are not authorized to accommodate overspending on specific projects just by the fact that they are underspent in their capital plan in the current year (the "budget"). They must identify whether the overspending will result in a permanent pressure on their plan within the 10 year horizon and what other projects must be cut back, delayed or cancelled to accommodate the permanent pressure.

Any changes to approved capital projects/sub-projects due to overspending, acceleration, deferral, or change in project scope, the addition of a new project, and unplanned use of non-debt funding requires budget adjustments to amend total project costs, current year cashflow estimates and funding and future year (if multi-year projects) while maintaining debt funding at the approved levels in each of the 10 years. This control requires a permanent reallocation of funding from other projects with like funding sources in the current year (with appropriate adjustments to these projects) and any future year projects in the 10 –Year Capital Plan. Funding must be in place to award contracts.

Any changes to the approved Capital Budget and Plan must be reported to and approved by Council, to ensure compliance with the City's Financial Control By-Law. All City Programs and ABCs must adhere to this financial control policy and the reporting and approval process to seek Council approval through Committee for in-year adjustments to their Capital Budget and Plan.

Operating Budget Preparation and Monitoring

Preparation

In approving the annual Operating Budget for each City Program and ABC, Council approves:

- total gross expenditures required to fund the total cost of providing the services, service levels and staff complement as reflective in the Operating Budget;
- total revenue as summed by the individual non-tax revenue sources; and
- the resultant, net expenditures that determine the level of residual tax-supported (or rate-supported) funding required to balance the Operating Budget for each City Program/ABC and in whole.

The total tax-supported funding required to balance the City's other revenue sources with its gross expenditures is generated by the tax levy on the basis of affordability, policy and other economic considerations regarding appropriate increases to the tax rate. It is important to note that the City's total staffing complement count is recorded annually with Council approval of the Operating Budget.

Operating Budget submissions must include:

- ✓ Gross expenditures, revenues and resultant net expenditure for the budget year and the following 2 years in the level of detail prescribed in the *Operating Budget Submission Guidelines and Instructions* which must meet budget target and comply with key guidelines and requires:
 - A base budget request, adjusted for prior year impacts and annualized costs, that provides funding of approved (prior year) services, service levels and associated staff complement in current year dollars and includes projected actual expenditures to year end, comprised of:
 - A detailed salary cost listing broken down by position type of the salary and benefit costs for the budget year
 - Business cases to justify any base budget or revenue change from the prior year's approved budget
 - Service Changes to reduce the base budget to meet budget targets in the form of business cases and categorized as efficiencies, revenue changes, minor or major service changes
 - New and Enhanced Service Request business cases to expand existing service levels, add new services or new revenue sources,
- ✓ Key Accomplishments for the prior year; Strategic Directions for following 3 years
- ✓ Performance Measures and Benchmarks

While Council explicitly approves the gross expenditure, gross revenue and net budgets for each City Program and ABC, the information included above provides the service and staff complement levels, or basis, upon which the estimates are approved. It is necessary information to determine if the actual spending results are the result of service level accomplishment or service change. This is key to monitoring budget performance throughout the year.

Financial Planning Division staff have a significant role in providing advice to all City Program/ABC staff to ensure guidelines and policies are clearly understood, interpreted and applied; operating business cases are categorized correctly and provide the requisite information.

Monitoring

Once the Operating Budget is approved by Council, it is controlled at gross expenditure levels. Any adjustment to these amend the City's budget and must be approved by City Council.

As part of the City's financial management and accountability framework, the Deputy City Manager and Chief Financial Officer reports quarterly to Committee and Council to provide year to date and projected year-end spending and revenue performance, to identify any issues and provide mitigation strategies, and, if required, for approval of any budget adjustments to the Capital Plan and Operating Budget.

Each City Program and ABC is responsible for regularly monitoring its approved capital and operating budgets to ensure that budgets are not overspent and to submit variance reports on a quarterly basis to the Financial Planning Division based on the timeframes and information requested.

City Programs and ABCs are expected to deliver their services at the service levels outlined in their operating budget and within the Council approved budget estimates. Any proposed changes to services or service levels and associated staffing requirements during the year must also receive Council approval, as these amend the gross expenditures and revenue sources, regardless of the funding source, as well as the City's overall staff complement count.

In cases where full funding is provided by third parties or other orders of government, these are approved and operating budgets are adjusted accordingly. For example, Public Health, Toronto Library and City community and emergency services regularly receive Provincial funding in-year to fund new or expanded services and staffing to deliver them. Even though there is no net tax impact, Council approval is still obtained to amend the gross expenditure and revenue estimates for these programs.

In-year requests to change approved services and service levels that would require increased tax funding for the current year and/or the following year are usually referred to the Operating Budget process for consideration with other service priorities and the City's overall affordability. Very few, if any, programs seek approval to amend the Operating Budget to add new services or change service levels in year.

In cases where service levels are subject to external customer demand such as Ontario Works applications, attendance to the Zoo or riders on the TTC, if demand is higher than expected, additional staffing and resources may be required to accommodate the added demand. Usually there is a corresponding increase in revenue to accommodate the additional resources but they may not be enough to cover the added cost or sustain the added costs over time. As a result, Programs are required to report the expenditure and revenue impacts of these added demands to Committee and Council for approval to amend their operating budgets.