

Financial Management and Control By-law Review and Update

Date: March 9, 2018
To: Executive Committee
From: Acting Chief Financial Officer
Wards: All

SUMMARY

This report presents the outcome of the first comprehensive review of the Financial Control By-law since its adoption in 2000, recommends changes that will address short-comings of the current By-law and establish clear lines of responsibility within a holistic, integrated financial governance framework that will ultimately strengthen financial management and control for the City.

The By-law is a key instrument in managing public resources, contributing to sound financial decision-making and enhanced accountability and transparency in managing the financial affairs of the City. As a result, it is recommended that the Financial Control By-law be renamed the "**Financial Management and Control By-law**" to reflect a more broadened and comprehensive financial management and governance framework based on best and leading practices.

The recommended Financial Management and Control (FMC) By-law is based on four governing principles that are pillars of prudent financial stewardship: *Accountability, Transparency, Agility and Control*. In addition, the FMC By-law provisions were developed based on specific guiding principles, particularly in budgeting, spending, monitoring and reporting, and matters requiring specific guidance. These governing and guiding principles provide the underlying rationale for the provisions in the FMC By-law and will support the appropriate balance between legislative authority and accountability over public resources and the agility required to deliver services and infrastructure in a fiscally responsible and sustainable manner.

The review of the current By-law was designed with a two-phased approach. This report presents recommendations for changes and additions to the current By-law to strengthen and consolidate the provisions based on the outcome of Phase 1 of the By-law's review. Phase 1 updates the current By-law to reflect current financial planning and management policies and practices where absent; clarifies authorities; addresses

gaps identified by stakeholders; and cross references with other relevant By-laws and policies to provide a comprehensive Financial Management and Control (FMC) By-law document under an overarching Chapter in the Toronto Municipal Code.

Phase 2 will further strengthen financial governance, planning, management and oversight to incorporate applicability of the FMC By-law to City Agencies and Accountability Offices and implement key actions regarding improved oversight and information to support strategic decision-making in accordance with the City's Long-Term Financial Plan.

The recommended FMC By-law improves the organization's agility by increasing delegated financial authority to the Chief Financial Officer to reduce approval time before spending can occur for expenditures up to \$500,000 within City Council's current financial delegated authority. It provides definitions; lays out clear authorities and approval processes; and simplifies Schedule A (authority to pay certain expenditure accounts outside the procurement process) to improve understanding and application. In addition, the FMC By-law will enhance financial reporting to City Council for better financial decision making by expanding the requisite information provided in the financial impact statements of City staff reports.

The Executive Director of Financial Planning and City Treasurer will work with City Programs to ensure that the provisions in the recommended FMC By-law, which will come into effect July 3, 2018, are implemented. Communication, training, and tools will be developed to support the implementation of the FMC By-law provisions, as part of the full roll-out to the City.

RECOMMENDATIONS

The Acting Chief Financial Officer recommends that:

1. City Council adopt a revised Financial Management and Control By-law as Chapter 71 of the Toronto Municipal Code, based on the summary set out in Appendix 1 of this report, and repeal the current Chapter 71, Financial Control By-law, all to be effective July 3, 2018.
2. City Council amend Municipal Code, Chapter 195, Purchasing, to align definitions with definitions in the revised Chapter 71.
3. City Council authorize and direct the City Officials to amend relevant policies and procedures that may be required to give effect to the revised Financial Management and Control By-law.
4. City Council authorize the City Solicitor to introduce the necessary bills to give effect to City Council's decision.

Implementation Points

The Financial Management and Control (FMC) By-law will come into effect on July 3, 2018. City Programs are already compliant with many requirements of the FMC By-law; however, the Chief Financial Officer will amend relevant financial policies and procedures, where appropriate, for alignment with the provisions of the FMC By-law and will develop tools, communication and training materials to support the implementation of the FMC By-law provisions.

FINANCIAL IMPACT

Approval of the Financial Management and Control (FMC) By-law will enhance accountability and transparency for managing City resources using a principle-based framework, balance financial accountability with agility, establish clear lines of responsibility for staff, and ensure consistent reporting of decisions with financial impacts and/or implications to City Council for decision-making in the City of Toronto.

DECISION HISTORY

The Financial Control By-law, Chapter 71 of the City of Toronto Municipal Code was adopted in March 2000 by City Council. The Chief Financial Officer is required to initiate a comprehensive review of this chapter every five years. While amendments have been made in ensuing years, this is the first comprehensive review of the By-law since its adoption.

Since 2000, the City of Toronto received greater autonomy over its financial affairs pursuant to the enactment of the *City of Toronto Act 2006*, implemented the approval of a firm 10-Year Capital Budget and Plan since 2009, adopted Multi-Year Service Based Planning and Budgeting in 2014, and made improvements in variance reporting to align with principles and practices of sound financial management.

Consideration of these factors necessitated that a full review of Chapter 71 is now required to provide a broadened and integrated financial management and governance framework that cross references other relevant By-laws in an overarching Chapter of the Toronto Municipal Code.

The current Financial Control By-Law, City of Toronto Municipal Code Chapter 71, can be accessed at: http://www.toronto.ca/legdocs/municode/1184_071.pdf.

ISSUE BACKGROUND

The City of Toronto's financial practices have undergone rapid change in response to numerous factors, including the *City of Toronto Act, 2006*, introduction of service-based, and multi-year capital planning and budgeting, changes in public sector accounting standards, as well as the maturing of other financial management practices. As a result, the current By-law is outdated and ambiguous in some areas, including unclear accountabilities, is silent on monitoring and reporting requirements, and inconsistent in the level of guidance provided in certain areas of financial management.

The By-law review has been designed in two phases. As part of Phase 1, certain areas have been revised to reflect current practices with a focus on:

- Providing a principle-based framework for financial management and control;
- Broadening the current By-law to include all aspects of financial management practices;
- Providing clarity and ensuring consistency with current policies and practices regarding budget approval, expenditure management and control, in-year budget adjustments and reallocations, monitoring and reporting, commitments, and delegation of financial authorities;
- Incorporating the Auditor General's recommendations for reporting on the status of major capital projects and the State of Good Repair (SOGR) impact for new capital projects;
- Expanding financial reporting requirements in staff reports to Committees and City Council; and
- Creating necessary alignment with the new Chapter 195, Purchasing By-law.

During Phase 1 of the review, City staff undertook a thorough engagement process with stakeholders from all City Programs to identify issues from both a program and corporate perspective. Staff also conducted extensive literature and jurisdictional research to examine the financial frameworks of other governments for best practices in delegation of financial authorities and in-year budget adjustments. Proposed changes were assessed in consultation with subject matter experts and brought forward to a Steering Committee of senior staff representatives from across the City.

This report presents recommendations for changes and additions to the current By-law to strengthen and consolidate the provisions based on the outcome of the Phase 1 review, as reflected in Appendix 1 of this report. The FMC By-law applies to all City Programs including Toronto Public Health (TPH). Although it is governed by the Board of Health, TPH is considered a City Program that adheres to the City of Toronto's principles, policies, and accountabilities for financial planning, management and control consistent with other City Programs. However, Article 5 "Budgeting" of the FMC By-law applies to all City Programs and Agencies, Boards, and Corporations regarding budget submission directions, targets, requirements, and review process.

Phase 2 of the By-law's review will focus on further strengthening financial governance, oversight, planning and management, including alignment and integration with other key City initiatives. The scope of this review will include but not be limited to:

- Supporting the implementation of key actions regarding improved oversight and information to support strategic financial decision-making arising from the Long-Term Financial Plan;
- Integrating City Agencies, based on the outcome of a governance review of Agencies and Corporations, Accountability Officers, and other related City-wide initiatives (i.e. Capital Project Review, City-wide Real Estate Review) that may impact the FMC By-law;
- Reviewing and developing the requirements for the acceptance and use of grants and sponsorships;
- Reviewing remaining items or issues not addressed in Phase 1 for Schedule A, in light of non-competitive procurement provisions in Chapter 195, Purchasing By-law;
- Addressing other issues as may be identified through further review.

Upon completion and full implementation of Phase 2 of the FMC By-law, the City will have a comprehensive financial management and control framework that will govern financial activities across all City Programs, Accountability Offices, and Agencies. The application of a single, cohesive framework will improve financial management and oversight, reduce the City's exposure to financial risks, and enhance accountability and transparency.

COMMENTS

The Financial Management and Control (FMC) By-law is an important element of the City's financial governance framework and is essential in managing public resources and risks more effectively, contributing to sound decision-making, and enhancing financial accountability and transparency.

The current By-law lacks a comprehensive approach to financial management and control that is necessary to provide a solid foundation for managing the City's resources. While numerous advancements have been made to strengthen the City's financial management functions, the current By-law does not reflect these developments in areas such as financial accountability, reporting requirements, and other budgetary and accounting practices.

The issues identified through the stakeholder engagement were relatively consistent across City Program areas. These have been addressed with revisions being made in the following areas:

- Budgeting
- Monitoring and Reporting
- Specific Guidance on Commitments and Contract Amendments, Donations, Sponsorships, and Schedule A

The key provisions of the Financial Management and Control (FMC) By-law are attached to this report as Appendix 1. Below is a summary of the significant changes being recommended to the existing Financial Control By-law.

1. A Principle Based Approach: Balancing 4 Governing Principles

The FMC By-law was reviewed and developed based on four governing principles that are pillars of prudent financial stewardship: *Accountability, Transparency, Agility and Control*. While the City has always operated under these four principles, they will be codified in the FMC By-law as follows:

- **Accountability** to City Council and the public for managing the City's financial resources.
- **Transparency** to City Council and the public on the use of public resources.
- **Agility** allowing for City to adapt to changes in the financial and operational environment.
- **Control** through systems and processes of internal control to ensure prudent stewardship of public resources.

A By-law based on well-expressed governing principles is less likely to become outdated or require frequent amendments, as these principles tend to remain stable over time. In addition, an understanding of the principles upon which By-law provisions are based, provides clarity of the intent and will lead to less misinterpretation.

While the governing principles have guided the provisions of the overall FMC By-law, finding the right balance is a challenge. The recommended FMC By-law reflects an appropriate balance between the four governing principles within the current financial governance framework. Supporting these governing principles are specific guiding principles in the areas of budgeting, monitoring and reporting, and on matters requiring specific guidance which are presented in the respective sections of this report.

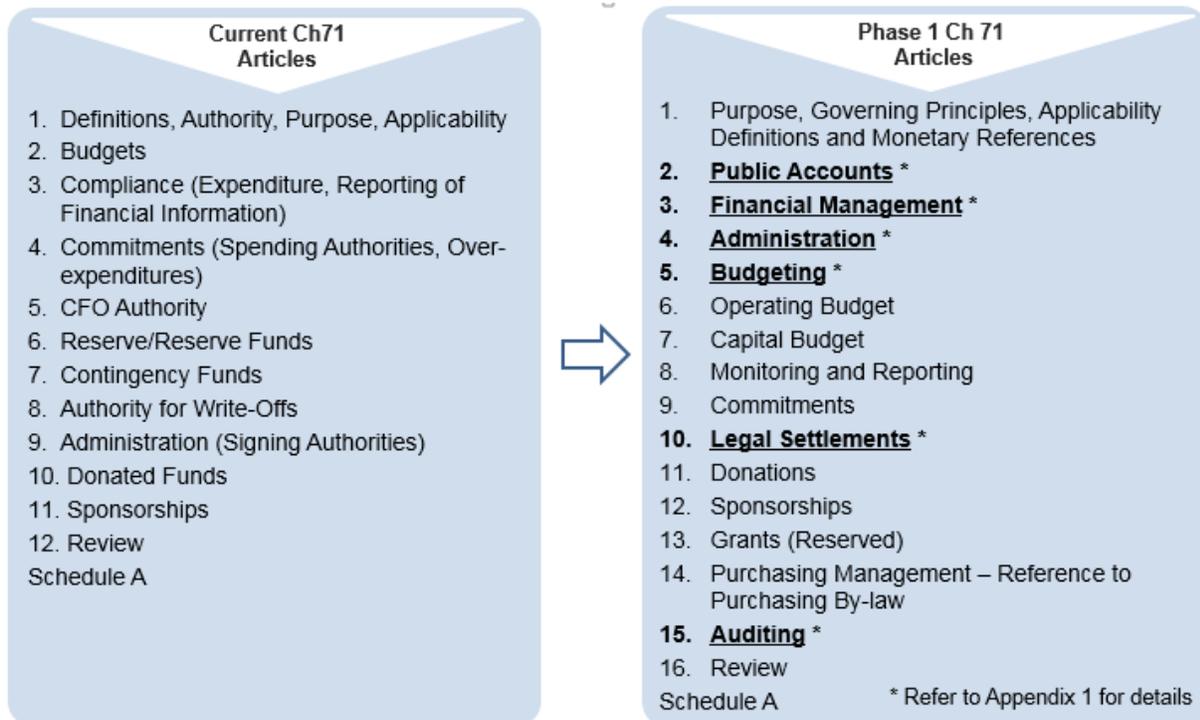
2. Broadened Scope for Inclusion of Other Financial Management Practices

The current By-law will be broadened to incorporate related financial management policies and provisions into one Chapter and the By-law's purpose statement has been revised accordingly. Once enacted and fully implemented, the Financial Management and Control (FMC) By-law will be a robust document to provide a more comprehensive financial governance framework for the City of Toronto.

Since the City's finances are regulated by various By-laws both within and outside of the Toronto Municipal Code, the *City of Toronto Act, 2006*, and City policies, the FMC By-law will be broadened to incorporate related financial management policies, and will consolidate additional areas by cross referencing with other relevant Municipal Code Chapters that govern these financial management activities under an overarching Chapter 71 FMC By-law.

Chart 1 below compares the current and revised By-law and highlights/underlines the new articles regarding financial management, administration, and accountability best practices being added for inclusion in the FMC By-law.

Chart1:



The additional areas to be included in the FMC By-law are described below:

Public Accounts

- This section now outlines the City's reporting obligations, as legislated and required by City Council, to prepare the City's consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles established by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada, the basis of accounting, and the declaration of the City's fiscal year.

Financial Management

- This section will cross reference to relevant Municipal Code Chapters, City policies, and the *City of Toronto Act, 2006* that govern revenue management, debt management, investment management, and surplus management to provide a comprehensive document under an overarching Chapter.

Administration

- The roles of the City Manager and Chief Financial Officer in financial planning and management will be included with a cross-reference to the current Chapter 169, City Officials By-law which stipulates that the City Manager is responsible for managing the fiscal resources of the City and the Chief Financial Officer is responsible for the financial management and affairs of the City. In addition, this section of the FMC By-law clarifies that the Chief Financial Officer is responsible for providing financial advice to the City.

Legal Settlements

- This section will encode the delegated authority of the City Solicitor to negotiate and settle legal claims in consultation with relevant Division Head(s).

Auditing

- The FMC By-Law will recognize the City's audit functions by including the roles, responsibilities and reporting requirements of Internal Audit, the Auditor General and External Audit as they relate to various accountabilities.

Budgeting

- This section establishes the basis of budgeting and the end-to-end budget process including budget direction, targets, submission requirements, timelines, and administrative and political review process to reflect current practices. This article is discussed in further detail below.

The key provisions of these new articles are described in Appendix 1 attached to this report.

3. Budgeting

The *City of Toronto Act, 2006* permits City Council to adopt a multi-year budget from a 2 to 5 year duration provided that the budget is reviewed and confirmed annually within the multi-year planning period. Consistent with budget submission guidelines, each year City Program and Agency staff develop an annual Operating Budget with a 2-year Plan, and a 10-Year Capital Budget and Plan based on established financial planning policies, guidelines and City Council approved budget submission directions and targets.

The establishment of the City's multi-year budgets is grounded in the following guiding principles:

- i. As the financial stewards of public resources, City Council is accountable for the efficient and effective allocation of resources to fund services and infrastructure to meet priorities, and achieve its annual and multi-year goals.
- ii. The Budget is the primary financial policy document by which City Council appropriates funds and provides staff with spending authority to achieve their purpose and any changes to the value or purpose of those recommended funds

require City Council approval. The Budget serves as the basis of financial accountability.

- iii. The City must have transparent and accountable practices in place that command the trust and confidence in the use and management of public resources.

a. Basis of Budgeting

The City of Toronto, like other municipalities in the Province, develops its Operating and Capital Budgets on a modified cash basis. The modified cash basis takes into account the estimated revenue to be earned and estimated gross expenditures to be incurred, excluding future employment benefit costs, insurance costs, solid waste landfill closure costs, as well as amortization expenses for the fiscal year. The basis of budgeting will now be included in the FMC By-law.

b. Budget Development, Submission Requirements and Review Process

The City's Operating Budget establishes a 3-year plan while the Capital Budget establishes a 10-year plan for the allocation of resources required to fund services and infrastructure needed by the community to meet City Council's priorities and achieve the City's strategic goals.

Prior to the 2017 Budget process, the City Manager and Chief Financial Officer established budget targets and strategies, for both Operating and Capital Budgets, as the key direction for budget preparation for all City Programs and Agencies. Beginning with the 2017 Budget process, City Council has approved budget targets, guidelines, and timelines and the City Manager and Chief Financial Officer have communicated these Council directions, together with budget strategies, submission requirements, and the end-to-end budget and approval process and timelines to all City Programs and Agencies.

The current By-law does not reference the budget development, budget submission requirements and the City's budget review process. This report recommends that the FMC By-law includes provisions for:

- **Budget Direction and Targets** – budget targets are annually established by City Council, except for the fiscal year following an election year when authority is delegated to the City Manager to establish budget targets, subject to confirmation by the incoming City Council.
- **Budget Development and Submission Requirements** – Division and Agency Heads are required to prepare budget submissions for their respective programs and agencies that comply with: established budget targets and timelines; budget submission directions and information in the form required by the City Manager and Chief Financial Officer; all relevant city policies; and all other information required and/or requested by City Council, the City Manager, or the Chief Financial Officer.
- **Budget Review Process** – City staff undertake an administrative review of all budget submissions, followed by Budget Committee's consideration and review of

Preliminary Budgets and Executive Committee's consideration and review of the Budget Committee Recommended Budgets. These budgets are subsequently reviewed, amended as required, and adopted by City Council.

4. Budget Approval

The City of Toronto Act, 2006, does not allow City Council to delegate its authority to adopt or amend the budget of the City. City Council approves Operating and Capital Budgets consisting of many components as defined in the following sections respectively. Since 2009, City Council has approved a firm 10-Year Capital Budget and Plan comprised of capital projects costs, cash flow funding for the current year, and future year commitments for multi-year projects, and planned project estimates in future years. In addition, since 2014, City Council has approved a service-based Operating Budget that approves a Program/Agency Budget comprised of its service budgets, staff complement, and service levels. The revised FMC By-law has been updated to reflect these City Council approvals.

a. Operating Budget

City Council currently approves the Operating Budget for each City Program comprised of the following components:

- Total gross expenditures and revenues as summed by the individual expense categories required to fund the costs of providing each service and individual revenue categories required to fund these costs by service;
 - The contributions to and withdrawals from reserve and reserve funds are also approved, where applicable, for each Program.
- The resultant net expenditures representing the amount of property tax revenues required to fully fund the Operating Budget for each service;
- Service levels by service; and
- Staff complement (permanent and temporary positions funded by both the Operating and Capital Budgets).

This report recommends that these components of the Operating Budget currently approved by City Council during the annual budget process be encoded in the FMC By-law.

b. Capital Budget and Plan

Each year City Council approves a 10-Year Capital Budget and Plan, including the annual Capital Budget. City Council provides staff with certainty about projects that will be implemented each year as well as spending authority for the current year and authority to commit future year cash flow funding for multi-year capital projects/sub-projects approved by City Council. This latter approval provides staff with the authority to award multi-year contracts for project delivery. This approach supports a multi-year planning and budgeting process that reduces the effort required annually to develop the Capital Budget and Plan.

When City Council approves a Program or Agency's 10-Year Capital Budget and Plan, it provides explicit approval for the following components:

- Total project cost and funding sources for each capital project/sub-project;
- Current year cash flow funding estimates (the Capital Budget);
- Future year cash flow funding commitments which are the expenditures related to a capital project/sub-project which will not be incurred in the current year but are expected to be required in future years based on the stages and scope of a project and for which contract obligations can be made; and
- Future year estimates for planned projects, in principle only.

The existing By-law must be updated to account for the City's multi-year capital budgeting practice and City Council's approval of a 10-Year Capital Budget and Plan, approval of capital projects' total project cost, the project's year 1 cash flow estimate and any associated and subsequent cash flow funding commitments, with the latter for a multi-year project duration.

This report recommends that the current By-Law be revised to account for City Council's approval of the components of a 10-Year Capital Budget and Plan as well as Council's approval of a Capital Budget for the current year.

5. Interim Budgets

The current By-law recognizes the need for an Interim Operating Budget to be approved annually by City Council that gives City Programs and Agencies the spending authority to continue ongoing base operations from January 1 to the date City Council approves the Operating Budget for that year. The Interim Operating Budget cannot include expenditures for new or enhanced services as these new expenditures are subject to City Council's approval annually in the budget process.

The existing By-law, however, does not acknowledge the Interim Capital Budget that is approved annually by City Council that gives City staff the spending authority to continue expenditures on previously approved projects/sub-projects from January 1 to the date City Council approves the Capital Budget for that year. Similarly, no funds for new projects are included in the Interim Capital Budget as these are subject to City Council approval during the annual budget process.

As a result, this report is recommending that the FMC By-law be amended to include the requirements for an Interim Capital Budget to be approved by City Council and clarify that no spending for new and enhanced services and no new capital projects can be included in the Interim Operating and Capital Budgets, respectively.

6. Expenditure (or Spending) Control

a. Operating Expenditure Control

Effective spending control is a key tenet of sound financial management and establishes accountabilities for the use of public funds. The Operating Budget approved by City Council, in whole and in its respective parts (City Program, Agency and Non-Program Budgets), as well as the components that make up these budgets, establish the purpose for which the funds can be spent and the value or amount of funds that are allocated/appropriated to that purpose and their funding sources.

Should the value or purpose change, a new value or purpose be created or the accountability for the value and purpose change once the budget is approved by Council, then a budget adjustment is required to address these amendments to the budget during the fiscal year. The financial management and control authorities, processes and approvals are outlined in more detail in Section b "*Operating Budget Adjustments*" below.

Once the annual Operating Budget is approved by City Council (and or subsequently amends the budget), City Council sets the spending limit on the total expenditures that can be incurred by the City and the revenues it can generate or apply towards funding those expenditures.

Similar limits apply to respective City Program budgets – once approved, these budgets establish the spending limit on the total expenditures that a Division Head can incur (gross expenditures) and the revenue amount it will generate or apply to fund those expenditures (revenues) plus the remaining portion to be funded from property taxes (net expenditures).

The current By-Law controls spending at a Program's gross expenditure budget level only and Division Heads are expected to ensure that gross expenditures do not exceed the approved Operating Budget. Division Heads are required to report any anticipated over expenditures to the Chief Financial Officer and appropriate Committee of Council as soon as the potential over-expenditure is known.

The FMC By-Law has been updated to account for spending to be controlled at the Program's gross expenditure, revenue and net expenditure budget levels. This is grounded in the principle that funds are appropriated and expenditures are incurred for their intended purposes as approved by City Council. A Division Head must ensure that expenditures are not incurred unless sufficient funds are available in the Program's gross expenditure budget. However, a Division Head may exceed the gross expenditure spending limit while ensuring that the net expenditure budget is not exceeded except in the following unforeseen and uncontrollable one-time events:

- An urgent unacceptable risk to the health and safety of persons or property;
- An incident that may cause significant service disruption; or
- New legislative obligations or requirements.

In the event of revenue shortfalls or expenditures resulting in an over-expenditure of the Program's net expenditure budget, a Division Head is required to report to the Chief Financial Officer as soon as it is known with mitigating strategies that provide corrective actions to be taken and / or a funding source to offset these over-expenditures or revenue shortfalls.

In addition, these over-expenditures or revenue shortfalls are subsequently reported to the appropriate Committee at the earliest opportunity.

When a donation up to \$50,000 or a sponsorship less than \$500,000 is accepted by a City Official in accordance with the delegated financial authority pursuant to the FMC By-law, a Division Head must seek City Council approval to make appropriate budget adjustment at the next available opportunity.

b. Operating Budget Adjustments

A budget adjustment is required if there is any change to the value or intended purpose in the approved Operating Budget. According to Government Finance Officers Association (GFOA) best practices in municipal budgeting, governments should have a policy and process in place whereby the Operating Budget can be adjusted within the fiscal year should unforeseen events require changes to the Operating Budget originally approved by City Council.

The current By-law delegates financial authority to reallocate funds to the Chief Financial Officer with a required subsequent approval by the City Manager for in-year Operating Budget adjustments of up to \$500,000. Any adjustments to the Operating Budget of more than \$500,000 requires the approval of City Council before such adjustments can be made.

Based on a jurisdictional review, Council's current delegated financial authority threshold of \$500,000 for budget adjustment approvals remains unchanged. To improve agility, the delegated financial authority will now rest with the Chief Financial Officer only rather than both the Chief Financial Officer and the City Manager.

Existing By-law provisions require updating to reflect the City's current practice of requiring City Council approval for changes to a Program's gross expenditures, revenues, net expenditures, staff complement (permanent and temporary positions funded by both the Operating and Capital Budgets) as well as permanent changes to service levels by service.

Key factors in determining whether a budget adjustment is delegated to the Chief Financial Officer is determined by the following considerations:

- Impact on a Program's Budget and staff complement;
- Financial threshold (\$500,000);
- Service level impact;
- Permanent or temporary nature of the budget adjustment (within the fiscal year only); and
- The existence of a future year financial impact.

Budget Adjustments Requiring City Council Approval

City Council approval is required for:

- transfers between approved Program Operating Budgets,
- changes to an approved Program's gross expenditure, revenue, net expenditure budgets, service levels by service, and the composition of staff complement (permanent and temporary positions funded by both the Operating and Capital Budgets), and

All other changes to the approved Operating Budget require City Council approval when the budget adjustment is made either:

- **Between** services provided that the reallocation is
 - permanent, or
 - temporary with a service level impact and greater than \$500,000.
- **Within** a service provided that the budget reallocation is
 - permanent with a service level impact,
 - temporary with a service level impact and greater than \$500,000, or
 - results in future financial impact.

If funds are not available to award a contract, a budget adjustment is required before a commitment is made and may require City Council approval, as described above.

Budget Adjustments Delegated to the Chief Financial Officer

The recommended provisions for in-year Operating Budget adjustments in the FMC By-law will provide a balance between financial accountability and greater agility to City Programs in responding to operational or environmental changes. These revised provisions will clarify the conditions in which budget adjustments may be made within delegated authority and will streamline the approval process by resting final approval authority with the Chief Financial Officer.

As a result, all budget adjustments must be approved by City Council, except where financial authority is delegated to the Chief Financial Officer to approve operating reallocations, as set out below:

- **Between** services provided that the budget reallocation and service level impact is temporary (within the fiscal year only); is an amount equal to or less than \$500,000; and does not result in a future financial impact. The budget adjustment must be reported to City Council at the next available opportunity.
 - If an over-expenditure occurs by a service that can be offset by an under-expenditure in another service without a service level impact, no budget adjustment is required. Programs will report variances through the variance reporting process at the next available opportunity.
- **Within** a service provided that the budget reallocation and service level is temporary; is an amount equal to or less than \$500,000; and does not result in a future financial impact.

- If the budget reallocation (within a service), whether temporary or permanent, results in no service level impact and has no future financial impact, then the financial authority is delegated to the Chief Financial Officer who can approve the reallocation regardless of the amount.

To ensure continued transparency on the use of resources, all budget reallocations delegated to the authority of the Chief Financial Officer with a service level impact are required to be reported to City Council through the variance reporting process at the next available opportunity.

It should be noted that the existing financial delegated authority provided to the Chief Financial Officer during any Council recess has been maintained at \$1,000,000 but now requires subsequent reporting to City Council through the variance reporting process at the next available opportunity.

In order to encourage accurate variance reporting and reduce the number of in-year operating budget adjustments, budget reallocations to reflect actual expenditures are not recommended and such adjustments to realign budgets and actual expenditures based on experience must be undertaken during budget preparation in the following year's budget process.

c. Capital Expenditure Control

The current By-Law authorizes a Division Head to approve additional expenditures where costs for a capital project increase to the extent that they do not exceed the original funding approval for the capital project by the lesser of 10 percent or \$500,000, if excess funds are available in another capital project within the Program.

This provision has been the subject of varying interpretation due to the lack of clarity regarding the basis on which the amount of the additional expenditure is to be determined, whether calculated on total project cost or current year cash flow funding. The current By-law also lacks details concerning eligible projects and funding sources to offset the over-expenditure, as well as any subsequent reporting requirements regarding these changes.

The FMC By-law clarifies existing provisions and requires that a Division Head must ensure that expenditures do not exceed the current year approved cash flow funding. However, consistent with current practice, an over-expenditure may still be occurred in a capital project or sub-project's current year cash flow funding, provided that the over-expenditure is the *lesser* of 10 percent of the approved current year cash flow (Capital Budget), or \$500,000. This authority is on condition that secured excess funds from another capital project within the Program must be available on a permanent basis; is not encumbered for another purpose; and there is no impact on the Program's total approved debt funding in the Capital Budget.

The Division Head is also required to notify the Chief Financial Officer and submit a capital budget adjustment to be reported to City Council at the next opportunity after the additional expenditure is made.

Where the FMC By-law delegates authority to a Division Head or the City Manager to receive and spend donations or sponsorships in relation to capital works in special circumstances. a subsequent budget adjustment and reporting to City Council is required at the next available opportunity for these capital expenditures.

d. Capital Budget Adjustments

A budget adjustment is required if there is any change in the value, intended purpose (scope), timing or funding sources of a capital project in the approved Capital Budget and Plan. The existing By-law provisions for in-year capital budget adjustments require updating to reflect the City's current practice of requiring City Council approval for changes to any components of a Council Approved 10-Year Capital Budget and Plan for a Program, including the total project cost and funding sources for each capital project/sub-project; current year cash flow funding estimates (Capital Budget); future year cash flow funding commitments; and future year estimates for planned projects.

In addition, the current By-law revealed a number of issues with the existing provisions for in-year capital budget adjustments:

- Inconsistency and lack of clarity on why the delegated financial authority for reallocation is only \$250,000 while other instances of delegated financial authority are set at the *lesser* of 10 percent or \$500,000.
- Lack of agility to enable staff to reallocate cash flow funding between years for a capital project/sub-project proceeding ahead of schedule, thus requiring an acceleration of cash flow funding where the overall project cost and debt as approved by City Council will remain unchanged.
- Absence of direction on the reallocation of eligible funding sources and the authority to adjust funding sources for a capital project/sub-project without impact to total expenditure approval.

The recommended FMC By-law clarifies and confirms that the in-year Capital Budget reallocation threshold is based on the current year cash flow value and not the total approved project cost value. In addition, the FMC By-law will align the delegated financial authority for the reallocation of funds with over-expenditures on capital projects/sub-projects by City Council, thereby increasing the delegated financial authority to the Chief Financial Officer to \$500,000 to be consistent with other delegated financial authorities in the FMC By-law.

Budget Adjustments Requiring City Council Approval

City Council approval is required for the following:

- Transfers of funding between Program Capital Budgets,
- Changes to a Program's Capital Budget current year cash flow funding, approved funding sources and total project/sub-project cost,
- Creation of a new capital project that was not as part of the approved Capital Budget, regardless of the amount,

- Re-allocations greater than \$250,000 and more than 10 percent of the current year cash flow funding between \$2.5 million and \$5.0 million, or
- Re-allocations of cash flow funding greater than \$500,000.

Budget Adjustments Delegated to the Chief Financial Officer

- The recommended FMC By-law provides the Chief Financial Officer with the delegated financial authority for capital budget adjustments, as set out below:
 - Reallocations of cash flow funding **between** capital projects/sub-projects within a Program for the current year that has no debt impact provided that:
 - the capital reallocation is not being used to create a new capital project that was not approved in the Capital Budget; and
 - sufficient funding remains in the project/sub-project from which the transfer is made to complete capital work after the reallocation.
 - **Changes to funding sources** for a capital project/sub-project provided that the funding source is unrestricted and the reallocation to reflect the funding source change is within the delegated financial authority threshold.
 - **The acceleration/deferral** of future year cash flow funding commitments with corresponding cash flow funding offsets or deferrals from another project/sub-project that do not change the total project cost, the scope of the project, or approved debt . The acceleration or deferral must be within the delegated financial authority threshold.
 - The financial authority delegated to the Chief Financial Officer for all the above budget adjustments are subject to the following thresholds and does not impact approved debt:
 - the reallocation of the current year cash flow funding is up to \$250,000; or
 - the reallocation of the current year cash flow funding is greater than \$250,000, up to the *lesser* of 10 percent of the current year cash flow funding or \$500,000.

Increasing the delegated financial authority of the Chief Financial Officer to \$500,000 for capital reallocations and acceleration/deferrals will not only provide City Programs with greater agility to deliver capital works based on readiness, but will also ultimately improve the capital spending rate. It is expected that the number of budget adjustments that require City Council approval will be reduced significantly.

It should be noted that the existing financial delegated authority provided to the Chief Financial Officer during summer or any Council recess is maintained at \$1,000,000 but has been increased to \$3,000,000 during Council's election recess. This increased threshold is consistent with past practice.

Similarly, to ensure transparency to City Council and the public, all delegated capital reallocations authorized under the FMC By-law are required to be reported to City Council through the variance reporting process at the next available opportunity.

7. Monitoring and Reporting

The City has a range of financial reporting responsibilities to various stakeholders, including City Council and the public. Reporting is a critical component of good financial stewardship as it ensures accountability and transparency through the provision of meaningful information that will facilitate informed decisions.

The City's current financial reporting practices to City Council and the public include operating and capital budget variance reporting, major capital project reporting, capital project closures, and financial reporting protocols, guided by the following principles:

- i. The City is committed to transparency and accountability by establishing a standard basis for reporting all financial information to City Council and its Committees.
- ii. City Council and its Committees, in making decisions, should have full knowledge of financial implications before approving matters that impact current and future years.

a. Budget Variance Reporting

The current By-Law is silent on the requirements to report to City Council on operating and capital variances other than requiring a Division Head to report to the Chief Financial Officer and Committees on any anticipated over-expenditures.

The Chief Financial Officer currently prepares quarterly and year-end variance reports for the Operating and Capital Budgets, which are generally submitted to City Council through Budget Committee within 45 days of the close of the reporting period and/or the first scheduled Budget Committee meeting.

To reflect this current practice, the FMC By-law requires Division Heads to submit detailed information on all Operating and Capital Budget variances within the timelines and format determined by the Chief Financial Officer. The Chief Financial Officer will submit a consolidated variance report to City Council through Budget Committee at a minimum of three times per year for the following reporting periods ending:

- 6 months from the start of the fiscal year;
- 9 months from the start of the fiscal year; and
- the end of the fiscal year.

b. The Closure of Completed Capital Projects

City Programs are required to perform due diligence in closing completed or inactive projects/sub-projects on a timely basis. Closing projects and sub-projects supports more efficient and accurate reporting and enables staff to focus attention only on active projects/sub-projects.

The current By-law does not include a provision for the closure of a capital sub-project without also closing the capital project. The current By-law stipulates that if cash flow forecast for any capital project approved in previous year is not included in a

subsequent Capital Budget, the capital project shall be considered to be completed and ready for closure. The Chief Financial Officer must “*submit a report to City Council for information on an annual basis detailing all capital projects closed during the year*” after consultation with the Division Head.

To provide clarity and ensure consistency with current practice, it is recommended that the provisions for the closure of capital projects be revised to account for both the closure of capital projects and sub-projects and the City's now more frequent reporting to City Council through the variance reporting process as well as the requirements for reporting on major capital projects.

c. Major Capital Project Reporting

In compliance with Auditor General recommendations to provide additional status reporting on all major capital projects as a means to strengthen accountability, manage risks, improve controls, and ensure successful completion and implementation of projects, the recommended FMC By-law will incorporate reporting requirements for major capital projects, necessitating periodic updates to the appropriate Committees and City Council throughout the lifecycle of major capital projects.

The FMC By-law provides criteria for determining which projects are classified as major capital projects, a determination to be made by the Chief Financial Officer in consultation with a Division Head during the administrative review stage of the budget process. Reporting will require the following additional information to be provided at various stages of a major capital project:

- *Initial project approval* - New projects will be considered for initial approval during the annual budget process. Before the project begins, a Division Head is required to submit a stand-alone report to City Council through the appropriate Committee for new major capital projects that are proceeding based on the results of a feasibility study with a schedule, milestones, and financial information in the form required by the Chief Financial Officer according to the Major Capital Project Reporting Policy.
- *Ongoing status reporting* - The quarterly capital variance report will provide additional details on the overall status of major capital project. The status of major capital projects will also be included in the Capital Budget Notes prepared for the annual budget process.
- *Stand-alone reporting thresholds* - A stand-alone report prepared by a Division Head to the appropriate Committee is required if there are changes in any of the major thresholds established during the initial project approval, such as cost escalation, delays in milestones/deliverables or changes to anticipated operating impacts, ongoing maintenance or financial and operation benefits identified in the initial project approval reporting.
- *Project completion reporting* - on completion of a major capital project and prior to project closure, the major capital project must be reported as a stand-alone report

to the appropriate Committee in the form required by the Chief Financial Officer according to the Major Capital Project Reporting Policy.

d. Financial Protocols – Expanded Financial Reporting Requirements

Staff reports are currently submitted to a Standing Committee, Community Council, and City Council throughout the year for the purpose of either providing information or advice and seeking approval or direction on a municipal matter.

The current By-Law provides direction on certain information that must be included in the financial impact section of a staff report before it can be submitted to a Standing Committee, Community Council or City Council. The current By-law also stipulates that the Chief Financial Officer must review the report and agree with the financial implications identified in the report prior to the report's submission. If not in agreement, the Chief Financial Officer may submit a companion report with recommendations respecting the financial implications.

An expanded list of mandatory information requirements is recommended in the FMC By-law in order to improve the range of financial information available to City Council and its Committees to support its decision making. These new requirements will give City Council and its Committees a longer term view of the City's financial position through the identification of potential multi-year expenditure and revenue implications and financial risks. It also enables for the implementation of Auditor General recommendations by codifying the requirement to include future State of Good Repair (SOGR) costs when considering the approval of the creation of new capital works.

The FMC By-law will amend existing provisions in the City's financial reporting protocol to include the following additional information requirements, where applicable:

- Implementation and/or construction costs arising from the results or findings of an approved study, environmental assessment, or any other preliminary work that could identify future capital needs;
- Budget estimates for state of good repair for the acquisition, construction or betterment of City assets, in accordance with the Auditor General's recommendation;
- Financial impacts, performance targets, and timing for the implementation of multi-year strategies and plans (e.g. Service Plans, Strategies, Master Plans, and Secondary Plans);
- Performance targets for any new or enhanced service initiatives; and
- Financial risks associated with proceeding or not proceeding with staff recommendations.

Additionally, any staff report that recommends a budget adjustment, a proposed funding strategy or use of a reserve or reserve fund must be jointly signed by the Division Head and the Chief Financial Officer (or designate) which is consistent with the Chief Financial Officer's role in providing financial advice to City Council and its Committees.

Specific Guidance on Other Financial Management Matters

The City is committed to ensuring an appropriate balance of accountability, transparency and agility in financial management activities, and in particular, for Commitments, Donations, Sponsorships, and Schedule 'A' (authority to pay certain expenditure accounts outside the procurement process).

8. Commitment Authority

In the current By-law, commitments are defined as contractual obligations for the purchase of goods, services or construction, including the execution of any document evidencing a commitment by the City as well as, a settlement of legal obligations meeting certain criteria. Given this definition, the By-law outlines spending authorities delegated to the City Manager and other officials to make commitments. The current By-law provision also provides authorities to over-expend on commitments made.

The use of the term "commitment" as both a contractual obligation/document and legal settlement is inconsistent since it references both a purchasing document and a legal arrangement. As a result, it is difficult to properly assign authorities in the By-law for spending, over-expenditures and payment.

Furthermore, the existing definition and authorities do not align with the new Chapter 195 – Purchasing, which contains a definition for the term "contract", which is defined as an agreement between the City and a supplier for the procurement of goods and services. Finally, the delegated authority allowing over-expenditures on commitments does not align with current practice and delegation provided by the City Manager to Division Heads.

The FMC By-law will redefine a commitment to align with the definition of contract in the Purchasing By-law, such that a commitment will be the authority delegated to a City official to commit an expenditure of City funds by awarding and executing a contract. Accordingly, a commitment will now be a subset of such contracts, approved pursuant to authority delegated under the FMC By-law. Within the new By-law provision, the City Manager or designate has the authority to authorize commitments of not more than \$500,000 in any one instance, provided funding conditions are met and funds are available. The City Manager may also delegate the commitment authority to award a contract in any amount within the limit of \$500,000 to a Division Head, and may authorize the Division Head to sub-delegate to any individuals reporting directly to him/her.

The delegated authority for legal settlements has been separated in the FMC By-law into its own provision, allowing the City Solicitor to negotiate settlements of legal claims up to \$500,000 above the original amount of a contract or up to \$500,000 in respect of non-contractual legal claims, before requiring Council approval. Payment of legal settlements can be made following such negotiation and settlement.

The payment of both commitments and legal settlements can be made by the Treasurer or his or her designate provided verification of the amount owing related to

either a commitment or settlement is received from the Division Head or City Solicitor making the commitment or settlement.

In addition, the FMC By-law clarifies authorities related to over-expenditures on commitments (as referenced in the current By-law). Given the alignment of commitments to contracts in Chapter 195 – Purchasing, contract amendments are amendments to commitments or contracts awarded by the Bid Award Panel, Standing Committee or Council, for expenditures in excess of the original commitment or contract.

The FMC By-law provision more clearly articulates the authority granted to a Division Head, or his or her delegate, allowing amendments to such commitments or contracts to a maximum of 10% of the original amount, up to the Division Head's delegated authority but not exceeding \$500,000, provided funding is available. Furthermore, subject to financial authority delegated by the City Manager, the Chief Financial Officer or any Division Head to whom the City Manager has delegated financial authority, can authorize a contract amendment up to \$500,000. This differs from the existing By-law which required the City Manager to amend contracts up to that value. The requirement for Standing Committees to approve contract amendments beyond delegated financial authorities noted above remains.

During a Council election recess, the Chief Financial Officer is authorized to amend a commitment or a contract awarded by the Bid Award Panel, Standing Committee or City Council for expenditures in excess of the original amount of the commitment or contract up to \$1,000,000, provided funding approval is in place and requires subsequent reporting to the appropriate Standing Committee.

As a result of the clarity provided by changes to the sections related to commitments and contract amendments, ancillary changes are required to Chapter 195 – Purchasing, as indicated in Recommendation 2 of this report.

9. Donations

The current By-law is silent on a definition for donations and does not provide clarity around authority to accept, spend and report on donated funds.

The FMC By-law now contains a definition for donations consistent with the City's Donations Policy; namely, a donation is an unconditional and voluntary transfer of cash or in-kind contribution to the City, where no benefit accrues to the donor.

Currently, Division Heads may accept and spend donations of \$50,000 or less in respect of a program or capital project and in accordance with established policies. In addition, the City Manager has authority to accept and spend donated funds in excess of \$50,000 and up to \$500,000 on behalf of City Council only under the following circumstances:

- During the period between the last scheduled meeting of Council and the first meeting of a new Council after an election; or

- If regularly scheduled meetings of Standing Committees and Council are not held, for any reason, for a period of two months or longer.

In order to ensure full transparency and alignment to the budget approval process, the FMC By-law now clarifies the reporting requirements associated with the acceptance of all donations under delegated financial authority.

Division Heads and the City Manager during the exception period, as described above, must report the receipt and spending of donations under respective delegated financial authorities and seek City Council approval to adjust the Operating or Capital Budget as appropriate at the next available opportunity.

10. Sponsorships

The Toronto Office of Partnerships (TOP) actively seeks out strategic partners for initiatives that support programs and services offered by the City of Toronto and improve the quality of life for residents. The Partnership Office reviews potential sponsorships and finds the most appropriate Division within the City to allocate sponsorship funds. TOP also works closely with City Agencies to support existing partnerships.

The City's Sponsorship Policy approved by City Council, provides details with respect to the acceptance and use of sponsorships. It establishes City-wide protocols that align sponsorships with City programs and services; provides guidelines that facilitate and support opportunities for sponsorship; and creates a systematic approach to soliciting, managing and reporting on sponsorships received by City Programs.

The current By-law allows Division Heads to accept sponsorship funds and execute agreements as outlined in the Council-approved Sponsorship Policy, up to a value of \$500,000. The current By-law also lays out the process by which accounts are credited, budgets adjusted and use is reported, as required by the City's quarterly variance reporting process.

Although a further review of the governance and financial delegations required for the acceptance, use and reporting of Sponsorship opportunities/funds will be undertaken in Phase 2, in conjunction with the Toronto Office of Partnerships, there is a need at this time to align the current provisions with those recommended for operating and capital budgeting authorities. Therefore, at this time, this report recommends that the provisions in the current By-law be amended and the Sponsorship Policy be updated to clarify that sponsorship funds should be accounted for in the Capital Budget or the Operating Budget and a Division Head must seek an appropriate budget adjustment at the next available opportunity. In addition, delegated authorities will clearly articulate that the spending of sponsorship funds can be made pursuant to a Division Head's authority to commit funds as provided by the By-law.

11. Schedule "A"

Schedule A was added to Chapter 71, Financial Control By-law in 2004. The Schedule was reviewed in 2011, with the adoption of recommended items in 2014. Schedule A contains a list of items that can be processed for payment, pursuant to authorities granted to the Chief Financial Officer in the current By-law, without the need for a purchasing document or single source form.

The intent of Schedule A was to obtain authority from Council to procure the listed items without undergoing a competitive process or submitting non-competitive (single and sole source) documentation, and allowing for the payment of invoices for goods and services provided without the creation of a purchasing document. However, the use of this listing is problematic for a number of reasons. Schedule A, as it is currently documented and approved by Council, contains a number of items which are not purchases and/or are authorized for payment through other means, such as policy or separate Council approval. Examples include payments to current and past employees, costs associated with business travel and repayment of debt made as a result of Council approved debt issuance. In addition, the current version of the listing contains a number of items which are now exempted from Chapter 195 – Purchasing, as a result of changes to the purchasing by-law. Finally, the listing includes very specific inclusions rather than criteria which can be applied to expenditure types, resulting in the need for an Interpretation Policy to manage such expenditures.

As part of Phase 1 of the FMC By-law review, Schedule A was reviewed with the intent of removing those items for which authority to pay was contained in other governance documents, such as the City of Toronto Act or Chapter 195 – Purchasing as well as a number of items covered by the City's Business Expense Policy. The authority for reimbursement of expenditures, such as registration fees, metered taxi services, and employee business travel, aligns with authorities already provided through the FMC By-law. Finally, with the approval of the new Chapter 195 – Purchasing By-law, effective January 1, 2017, a number of items can be removed from Schedule A as they are specifically exempted from any procurement process, pursuant to authorities provided by the new Purchasing By-law. As a result, most non-purchase type payments have been removed from Schedule A.

The remaining items in Schedule A will require further research and discussion with respect to authorities required for both commitment and payment items associated with capital expenditures and funding and purchases authorized through non-competitive process. These items will be subject to review under Phase 2.

Current authorities to pay certain accounts have been updated to specifically reflect the remaining Schedule A items.

The revised Schedule A is attached to this report as Appendix 2.

Conclusion

The Financial Management and Control (FMC) By-law will consolidate and strengthen the City's financial governance framework by clarifying and encoding existing policies and practices with respect to financial management and control under an overarching Chapter in the Toronto Municipal Code.

The FMC By-law is based upon four governing principles as pillars of prudent financial stewardship: *Accountability, Transparency, Agility and Control*. It broadens the scope to include best practices for financial management and accountability and supports an appropriate balance between legislative authority over public resources and agility required to deliver services and infrastructure in a fiscally responsible and sustainable manner.

The Phase 1 review aligns the current By-law with existing financial policies and practices and addresses gaps identified by stakeholders, whereas Phase 2 will further strengthen financial governance, planning, management, and support key actions in accordance with the City's Long-Term Financial Plan and other key initiatives.

Upon completion and full implementation of Phase 2 of the FMC By-law, the City will have a comprehensive financial management and control framework that will govern financial activities across the whole of government. The application of a single, cohesive framework will improve financial management and oversight, reduce the City's exposure to financial risks, and enhance accountability and transparency.

The FMC By-law provisions related to Phase 1 will come into effect July 3, 2018. The Chief Financial Officer will ensure that the provisions in the Financial Management and Control By-law are implemented. In addition, communication, training, and tools will be developed to support the implementation and reinforce and strengthen the City's financial governance framework across the whole government through the application of a single comprehensive Financial Management and Control By-law.

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SIGNATURE

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ATTACHMENTS

Appendix 1 - Summary of Key Provisions for Toronto's Financial Management and Control By-law

Appendix 2 - Revised Schedule A