

Budget Process – Operating Component

In a municipal context, the budget is a communication tool that enables a municipality to inform the population of the directions taken and the strategic choices made to determine the level of taxation as well as the level of service of the various municipal activity sectors. It also allows resources to be allocated accordingly. Thus, to be able to produce a budget, the Ville de Montréal (the City) needs a structured process.

The City adopted a \$6.17 billion operating budget for fiscal year 2021, with 64.7% of its operations funded by \$4 billion in tax revenues. Expenditures, which are equivalent to revenues, are divided into 13 activities. Compensation alone represents a budget of \$2.5 billion, or 40.9% of budgeted expenditures. The budget's second major component is gross debt service, which amounts to \$1.1 billion or 17.2% of projected spending in 2021.

The budget process is complex and is governed by a host of laws and financial policies. It begins in January, when the preliminary financial framework is developed, leading to establishing orientations, and it ends in December with the approval of the budget by the authorities. In addition, it requires the participation of a large number of people in different business units and covers the island of Montréal, which corresponds to the territory of the agglomeration, including 16 related municipalities: the City (composed of 19 boroughs) and the 15 reconstituted municipalities.

Several information systems are used to prepare the budget, as well as several Excel files to collect and process the information required to establish forecasts.

Background

Purpose of the Audit

To ensure that the process supporting the preparation of the City's operating budget is efficient and rigorous.

The City has a specific management framework for the budget process and formal decision-making mechanisms for the orientations established to table a balanced budget. Nevertheless, we found that the preliminary fiscal framework developed to present five-year fiscal projections and inform decision-making is focused on the next year's budget. It is not followed by a balanced five-year fiscal framework that would expose the risks and challenges of the current projections—which is essential in the context of the City's growing structural budget imbalance.

The budget process is not part of an overall planning process. Organizational priorities communicated by the Direction générale are used as a backdrop, but the business units' budget is not necessarily based on these priorities or on their activities or service levels.

The current method for determining the orientations and budget envelopes for the business units is based instead on managing variances in revenues and expenditures in relation to the budget adopted the previous year. Thus, while some forecasts are well established, our work has revealed the existence of year-to-year over- and under-estimates for some categories of revenues and expenditures. This results in the variances being carried over year after year, compromising the accountability of the business units.

There have been some adjustments to the transfers from the central city to the boroughs, but they have not been thoroughly reassessed, since their funding was reformed in 2014, to determine whether they accurately reflect current needs and whether the parameters used are still appropriate. The funding model was to be reviewed after five years.

In addition, the published information does not allow for an assessment of the City's budget performance; it is only for one year, and it therefore is not possible to establish the trend of variances between forecasts and historical results.

The drafting of the City's \$6.17 billion operating budget relies heavily on a multitude of Excel files and outdated applications that are no longer supported by vendors and have required the implementation of compensating controls over time to mitigate risk.

It is imperative that the City review its budget process and adopt effective budget and financial systems so that it is better equipped to deal with current and future issues.

Main Findings

Financial Framework

- The financial framework focuses on the first year's budget, which makes it difficult to take into account the consequences over the next four years. No balanced five-year framework is prepared and published as part of the annual budget.
- The financial framework does not follow the City's recommended financial practices in terms of both documentation and consideration of actual historic results.
- Although the City has tabled its *Montréal 2030* strategic plan, the financial framework does not yet reflect the municipal administration's priorities.

Forecasting Revenues and Expenses

- Some of the assumptions used are not supported by proper documentation as required by the City's *Politique de l'équilibre budgétaire*.
- Our analyses show that the method used to establish revenue and expenditure forecasts results in over- or under-estimates from year to year. Thus, the budget does not clearly present the sources of funding and the planned expenditures.

Determining the Orientations and Drafting the Budget Envelopes

- Decisions made in determining budget orientations are not documented, and the method for allocating budget envelopes to business units does not take into account historic or future cost analyses on an activity-by-activity basis. It is based instead on managing the variances in revenues and expenditures from the budget adopted the previous year.
- The absence of assessments and benchmarks for the level of service or activity related to budgeted expenditures compromises the accountability of departments.
- No analysis has been carried out to assess whether the transfers from the central city, determined during the boroughs' funding reform in 2014, properly reflect their current needs, whether they are representative of the competencies devolved to them and the services provided to citizens, or whether they correspond to their fair share of the taxes collected by the central city for these services, despite the fact that they were to be reviewed after five years.
- Amounts are distributed to the boroughs, or reduced from transfers granted by the central city, even though they are not budgeted for. This practice is not conducive to budget transparency or the optimal allocation of resources during the drafting of the budget.

Arbitration, Consolidation and Adoption of the Budget

- There are no formal prioritization criteria to support the decision-making process for accepting new budget requests or for making cuts to the operating budget.
- Regarding the audited boroughs, the budget documents—published at the time of their presentation to the borough councils (BCs)—contained insufficient and, in some cases, very summary information.
- Also, the fact that certain boroughs present expenditure forecasts by activity, while the City's overall budget presents them by object, makes it difficult for the authorities and citizens to establish a link between these two types of information in order to appreciate the budget as well as the nature and evolution of expenditures.

Tools and Human Resources Involved in Drafting the Budget

- The budget system in place dates from the 1990s. As early as 2009, a study already pointed out the urgent need to replace these outdated systems and their inefficiency in delivering relevant, timely and error-free information. This project has been postponed twice due to a lack of human and financial resources. The drafting of the City's \$6.17 billion operating budget relies heavily on a multitude of Excel files and applications that are not integrated.
- With limited and outdated systems, the human resources assigned to preparing the budget spend a great deal of their time on clerical tasks, rather than on planning and doing more value-added analyses. In addition, the succession of certain key positions is not currently assured.

In addition to these results, we have made various recommendations to the business units, which are presented in the following pages. These business units were given the opportunity to agree to the recommendations.