



# Financial Review Audit

## TERMS OF REFERENCE

August 7, 2024



## Background

During the pandemic and post-pandemic period (2020-2023), the City of Saskatoon ('the City') has experienced operating deficits, which required the City to draw from reserves. In addition to reliance on reserves, in response to additional costs incurred as a result of the 2022 Emergency Snow Event, borrowing was also utilized as a funding source to offset relevant expenditures in 2022 and 2023. In 2023<sup>1</sup>, the City posted a surplus of \$9.9 million following a conscious decision to utilize borrowing to fund the decision to execute the City's Emergency Response Plan for city-wide snow clearing and removal, following the December 2022 significant snow event. Without the borrowing decision, the City would have realized a deficit of \$6.09 million before reserve transfer. In 2022 the City realized a deficit of \$10.99 million, \$6.54 million in 2021 and \$4.15 million in 2020. This audit aims to assess the City's operating financial performance (including comparison of select financial metrics to other municipalities) and develop remedial strategies to mitigate future operating deficits.

As required by [The Cities Act](#) (Part 9, Division 3, p. 83), all municipalities in Saskatchewan need to approve a balanced budget each year. Consequently, operating expenditures must be covered by operating revenues or reserve transfers and if there is any remaining funding gap, property taxes must be used to fund the remaining portion. The legislation mandates that the City cannot budget for an operating surplus or deficit, unlike federal and provincial governments. Therefore, it is important that the City's service levels, budget and actuals are in line to avoid operating deficits/surpluses, deliver the services its residents expect with the resources provided, endure economic challenges, and respond to changing circumstances. This approach also puts less pressure on the depleting reserves.

The City maintains 140+ reserves, with total year-end balance of \$259 million in 2022, to fund specific budget items or funds in compliance with specific agreements such as Land Development Levies. A reserve is an account for keeping funds for specific purposes. The City's Fiscal Stabilization Reserve plays a crucial role for balancing the operating surpluses/deficits during the fiscal year. It was established to mitigate impacts from fluctuations in operating results from year to year. It had a balance of \$6.7 million at the beginning of 2022 that was fully drawn for the first time in the past several years, to balance the City's year-end deficit for tax-based operations in 2022. For 2023, it is estimated that the reserve's balance will be replenished to \$5.8<sup>1</sup> million as a result of operating surplus in that year, primarily driven by the borrowing related to 2022 Emergency Snow Event.

As part of the approved Audit Plan, the Independent Office of the City Auditor (the 'Office') has commenced the Financial Review Audit.

## Audit Objective

The objective of the audit is to carry out an independent assessment of the City's financial health (including comparison to selected municipalities) and provide recommendations to reduce the possibility of future operating deficits.

## Audit Scope

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<sup>1</sup> Preliminary 2023 unaudited results (as presented during the March 6, 2024 SPC Finance meeting)

In preparation for the Terms of Reference, the audit team reviewed several financial documents at a high-level and met with Administration to discuss the audit objectives, scope and schedule and build an understanding of key processes.

The audit will include the following:

- Analyzing the City's operating budget, actuals, and relevant projections
- Examining key documentation associated with the City's past financial performance
- Assessing the City's operating budget variances, providing independent insights, and building on the similar previous work carried out by the Administration
- Carrying out benchmark analysis related to the City's financial health compared to selected comparator municipalities by:
  - utilizing relevant key performance indicators (e.g., operating position, fund balance as a % of total revenues, annual revenue change ratio, property taxes per capita), and
  - normalizing the absolute values based on the applicable common factor among the municipalities (e.g., population, area, etc.)
- Assessing the City's budgeting process through stakeholder interviews, gap analysis and maturity assessment

The areas to be covered within the scope of the audit will include the following:

## **1. Comparative Financial Assessment**

- Assess the financial health of the City by carrying out the following activities:
  - Analyze the City's financial reports for the past 5 years (2019-2023), including annual reports, operating and capital (as applicable) budgets, debt service schedules, grant-related documents, and other financial performance reports (as relevant) to identify major trends and performance variances, the City's corresponding mitigating actions, and subsequent budget impacts
  - Evaluate the effectiveness of the City's approach to managing surpluses/deficits (including utilization of Fiscal Stabilization Reserve, and Snow and Ice Management Contingency Reserve), its use of debt funding, etc.
- Analyze the health, composition, and effectiveness of the City's reserves, relative to comparable organizations, giving specific considerations to the following: reserve quantity, utilization, flexibility and policy approach
- Identify three relevant comparator municipalities by applying criteria for size/area, population, geography, similar weather conditions, operating budget, and composition of services offered
- Compare and contrast observations from the assessment of the City's financial health related to operating deficits/surpluses, reserve structure and benchmarking against the corresponding data points from comparator municipalities
- Identify key gap areas with comparator municipalities from which the City can draw upon any relevant improvement opportunities, and further enhance its fiscal strength and reduce possibility of future operating deficits

## **2. Variance Analysis and Insights**

- Analyze the City's financial reports from 2019-2023 period for variances in operating revenues and service expenses by each business line and service line, including:
  - Analyzing the changes between the years in this 5-year period to look for major negative patterns that can be mitigated/improved
  - Assessing the interim (mid-year) forecast and variance analysis reports (e.g., 2023 Year-End Projection by Business Line) and evaluate the effectiveness of the proposed mitigation actions by analyzing the budgeted vs actual results at the year-end
- Conduct an independent assessment of the variance reasons identified and provide additional insights into the potential key drivers contributing to the key operating budget variances. This exercise will be conducted through a series of interviews with key stakeholders and assessment of relevant documentation (e.g., operating and capital budgets) and building on the existing analysis carried out by the City Administration.
- Assess the sensitivity of the City's operating budget to the changes in the key drivers (e.g., snow and ice management expense category)
- Categorize variances based on various factors such as unit cost/price, volume, efficiency, to build a more accurate understanding of causes of variances and identify more relevant opportunities for improvement as part of developing the final report

## **3. Budgeting Process Assessment**

- Review relevant process documentation and conduct interviews with key stakeholders to understand the current state of the City's budgeting process and identify opportunities for improvement. The analysis will consider the following: recent budgets, internal budget policies, budget pressure mitigation plans, operational saving targets, multiyear business plans, etc.
- Analyze documents developed as part of 2024-2025 budget deliberations process and examine key assumptions used for the budget, including impact of main drivers, such as snow events
- Evaluate and assess the City's budgeting approach compared with other municipalities. Also, evaluate if the City has key financial policies to provide an overarching framework for managing the annual surpluses or deficits
- Carry out a maturity assessment utilizing maturity model by subject matter specialist for municipality budgeting process, such as revenue forecasting, expenditure planning, debt management and reserve/fund balance management activities
- Document and analyze current state findings related to the budgeting and forecasting processes to identify key gaps and their causes compared to the desired maturity level
- Assess whether other cities have contingencies built within their budget to provide funding for expenses unknown at the time of the budget and identify improvement opportunities for the City

## **4. Recommendations for Improvement**

- Document the findings identified during the comparative financial health assessment, variance analyses and insights, and budgeting process assessment activities described in the above sections
- Discuss the results and findings with the City Administration
- Based on the findings and gaps identified during the assessment activities, develop cost effective and practical recommendations to further improve the City's fiscal strength, including:
  - Identifying corresponding improvement initiatives for each budget component contributing the most to the past operating budget deficits
- Prioritize the initiatives based on how each initiative impacts and aligns with the City's goals (including reducing future large operating deficits) and the level of effort required for implementing each initiative
- Develop a high-level implementation roadmap based on prioritized list of improvement opportunities
- Validate the high-level implementation roadmap and final draft of audit report with Administration before presenting the report to the Standing Policy Committee on Finance

## Audit Approach

The audit team will use a structured approach, leveraging the subject matter specialist's methodology on similar assessment initiatives with comparable municipalities within Canada, including:

- Developing a high-level process overview for budgeting, utilizing the subject matter specialist's proprietary process repository and general sector knowledge
- Conducting a maturity model assessment using its Financial Planning & Analysis (FP&A) accelerator tool to assess the maturity of the budgeting processes, utilizing 5 areas of performance management framework (i.e., Planning, Reporting, Governance, Analysis, Business Partnership). The team will leverage this assessment to identify gaps between the current and desired state
- Identifying opportunities for improvement leveraging the subject matter specialist's process improvement framework
- Developing a high-level implementation roadmap based on prioritized list of improvement opportunities and map out the opportunities according to the level of effort and impact

## Deliverables

On completion of the audit, a detailed audit report will be submitted to the Standing Policy Committee on Finance in the September 2024 public meeting. The audit report will provide the results of the audit, including findings and recommendations and administrative responses and action plans to implement the recommendations. A status update and follow-up will be conducted in the future to assess whether the Administration has effectively implemented these audit recommendations.