



**CITY OF HAMILTON**  
**CITY MANAGER'S OFFICE**  
**Audit Services Division**

<b>TO:</b>	Chair and Members Audit, Finance and Administration Committee
<b>COMMITTEE DATE:</b>	May 18, 2017
<b>SUBJECT/REPORT NO:</b>	Evaluation of the Value for Money Pilot Program (AUD17013) (City Wide) (Outstanding Business List Item)
<b>WARD(S) AFFECTED:</b>	City Wide
<b>PREPARED BY:</b>	Charles Brown CPA, CA, CPA (Illinois) 905-546-2424 x4469
<b>SUBMITTED BY:</b>	Charles Brown CPA, CA, CPA (Illinois) Director, Audit Services City Manager's Office
<b>SIGNATURE:</b>	

**RECOMMENDATIONS**

- (a) That Report AUD17013 respecting the overall assessment of the Value for Money Pilot Program be approved;
- (b) That the two temporary full time equivalent (FTE) Performance Auditor positions be eliminated when the Value for Money Pilot Program ends on June 30, 2017;
- (c) That the Director of Audit Services incorporate value for money (VFM) auditing into the duties of the current permanent Auditors and, in consultation with Human Resources, reorganize to deliver the Program within its existing FTE complement;
- (d) That the Audit Services Division adopt an offering of services and activities that maintains capabilities in value for money auditing, as well as consulting, risk assessment, and investigation, to fully support the City's risk management, controllership and governance processes and continuous improvement initiatives;
- (e) That the Director of Audit Services explore the development of an Audit Rotation Program aimed at providing opportunities for 2 city staff to serve in ongoing rotational work terms in Audit Services under the sponsorship of departments;
- (f) That Items C and D on the Audit, Finance and Administration Committee's Outstanding Business List, respecting the Value for Money Audit Program (AUD12019) and Value-for-Money Audit Program – End of Three Year Pilot, be considered complete and removed from the Outstanding Business List.

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## **EXECUTIVE SUMMARY**

The purpose of the Value for Money Pilot was to explore the potential benefits of creating additional capacity in value for money auditing in order to better serve the needs of Council, and bring more relevance and alignment of audit work with the goals of ensuring effectiveness in the City's governance, risk management, control and accountability processes. It was intended that Audit Services use that capacity to conduct VFM audits, which are audits meant to go beyond the scope of traditional compliance and control by addressing the economy, efficiency and effectiveness of operations and processes for oversight and governance.

Direction was provided to report back to Council through the Audit, Finance and Administration Committee at the end of the pilot, summarizing estimated savings, in addition to highlighting benefits received such as improved controls, operational efficiencies and environmental, social or service improvements.

Many benefits have been realized from the addition of value for money capacity including recurring annual and one-time gross savings / revenues of \$1,298,000 - \$2,048,000 and \$41,000, respectively. In addition to savings, many other non-financial recommendations were presented as part of completed VFM projects, improving the efficiency and effectiveness of operations in areas such as Electronic Funds Transfer, Business Licensing, GPS/AVL utilization, Claims Adjustment, DARTS configuration, the City's Performance Measurement regime, Protective Plumbing, Reserves, Ontario Works Employment Services, and the Use of Consultants.

The Program has provided augmented capacity and skills that has enabled more innovation and supports a more modern approach to the audit function which incorporates a multiplicity of service offerings that includes providing advice, facilitation, risk assessment and consulting in addition to the core complement of compliance, control and VFM audits. This enables a more balanced approach to providing assurance – one that looks both retrospectively and proactively at issues of risk, governance and control. It takes greater advantage of the skills and experience auditors have, and leverages Audit toward finding solutions and anticipating organization challenges in the future.

Up to now the VFM program has been funded through reserves and has not secured permanent operational funding for the 2 FTE's under the Program.

It is recognized that the City faces significant pressures and constraints on its operating budget to which all departments and divisions must take a fiscally prudent approach.

There are also opportunities to incorporate further innovation in the delivery of audit services through an Audit Rotation Program – a program that offers a unique development opportunity for staff to gain experience in new disciplines and exposure to

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different businesses, functions, and practices. It leverages audit as a training ground for financial acumen and controllership, skills in project management, internal control, risk management, performance measures, business analytics and facilitation.

Going forward it is recommended that the VFM audit program and other services such as consulting and risk assessment be provided under the existing permanent FTE complement, and Audit Services explore the opportunity of developing a formal audit rotation program.

***Alternatives for Consideration – See Page 8***

**FINANCIAL – STAFFING – LEGAL IMPLICATIONS**

Financial: Additional costs that may stem from reviewing the compensation for current permanent Auditor positions are unknown at this time.

Additional annual levy-based funding for staffing (e.g. training, equipment and supplies) would be required for the Annual Audit Rotation Program and is estimated at approximately \$10,000. The cost of salaries and benefits would be incurred by the employees' home departments.

It is prudent to include an annual budget of \$25,000 to the Audit Services operating budget to allow for the retention of outside consultants in areas for which the Audit Services Division does not have expertise when carrying out VFM audits. Therefore, a \$25,000 annual increase in the operating budget will impact the general levy.

Staffing: Two temporary FTE Performance Auditor positions are eliminated. No levy savings would be realized as these two positions were funded from the Tax Stabilization Reserve.

Two FTE rotational positions added to the Audit Services Division staff complement dependent on departmental funding

Legal: None.

**HISTORICAL BACKGROUND**

On March 21, 2012, the General Issues Committee (GIC) received and approved Reports AUD11008 and CM11006 respecting the implementation of the hybrid Auditor General model and a three-year value for money audit program whereby two contract FTEs would be funded from the Tax Stabilization Reserve to perform VFM audits as approved by Council in the annual work plan.

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As part of the hybrid Auditor General model, the Director of Audit Services was designated an Auditor General (per the Municipal Act) via By-law 12-073 and a VFM auditing component was rolled into Internal Audit as a combined function. Generally, VFM audits are defined as compliance and operational reviews combined, with a component to assess whether or not the City has obtained benefit from the goods and services it acquires and provides. VFM assesses whether City operations and services are provided in an economical, efficient and effective manner.

Direction was given to report back to the Audit, Finance and Administration (AF&A) Committee:

- At the conclusion of each VFM audit with results and recommendations;
- Annually with identified tangible savings / increased revenues, if any realized, as a result of the implementation of recommendations made in the year; and
- At the end of the three-year pilot, summarizing the estimated cumulative savings in addition to highlighting the non-financial benefits such as improved internal controls, operational efficiencies and environmental, social or service improvements, as appropriate, resulting from the VFM program.

Two Performance Auditors were subsequently hired and the Value for Money Pilot Program commenced on March 18, 2013. There was a time delay between the GIC approval date and the Pilot Program start date due to difficulties recruiting qualified staff (as detailed in Report AUD12019 presented to the AF&A Committee in October 2012).

On July 10, 2013, the AF&A Committee approved the 2013 Performance Audit Work Plan (AUD13022) which contained several audit projects with a potential to produce cost savings or revenue generation. Four of these audit projects were completed when the two Performance Auditors were reassigned full time to complete a project pertaining to the Disabled and Aged Regional Transportation System (DARTS) at the direction of Council (effective November 2013 – September 2014). In addition to the DARTS Review, one FTE was diverted from the 2013 Work Plan to complete a review of Hamilton Police Service Issues one month and to perform consulting work on the Cash Handling Guidelines one month, both at the direction of Council.

On May 12, 2014, the results for the first year of the Pilot Program were presented to the AF&A Committee (AUD14012). In addition, the Committee approved funding for the duration of the Pilot term to provide stability and surety to the resources of Audit Services. As a result, reporting results for the second year of the Pilot Program was deferred to and combined with the overall program report at the end of the Pilot term.

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On March 9, 2015, the AF&A Committee approved the 2015-16 Performance Audit Work Plan (AUD15010) which contained a combination of audits in progress / carried forward from 2013 and new audits to carry the Pilot Program to March 31, 2016, the end of the three-year term. New audits were selected based on the assessment and identification of opportunities for improvements in the efficiency, effectiveness and economy of operations and value for the taxpayer dollars spent.

On October 13, 2015, Report AUD15027 was presented to the AF&A Committee summarizing estimated cumulative savings and highlighting non-financial benefits from the seven projects completed by the Pilot Program at the end of its three-year term.

As a result of the Performance Auditors being reassigned from completing VFM work to carry out projects requested by Council, the AF&A Committee decided to extend the Value for Money Pilot Program for an additional 15 months up until June 30, 2017 using funds from the Tax Stabilization Reserve. Direction was given to report back to the AF&A Committee at the end of the extended Value for Money Pilot Program, summarizing the estimated cumulative savings in addition to highlighting the non-financial benefits such as improved internal controls, operational efficiencies and environmental, social or service improvements, as appropriate, resulting from the VFM program.

This report fulfils the requirement to report back at the end of the extended VMF pilot, summarizing estimated cumulative savings and highlighting non-financial benefits.

## **POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS**

In 2012, By-law 12-073 designated the Director of Audit Services as an Auditor General per the Municipal Act. There are no additional policy and legislative implications at this time. The Director of Audit Services continues to be designated as an Auditor General per the Municipal Act.

## **RELEVANT CONSULTATION**

The City Manager and General Managers were consulted during the report writing process.

## **ANALYSIS AND RATIONALE FOR RECOMMENDATION**

To continue the benefits of value for money auditing it is recommended that the program be delivered within Audit Services existing complement of FTE's supplemented by rotational assignments resourced through an Audit Rotation Program. This would offer the best opportunity to resource needs of the Audit Work Plan, while adding new skill sets and experience to the Division and development opportunities for high potential staff in departments.

### **Achievements of the Pilot Program**

Appendix "A" of Report AUD17013 contains a list of the projects completed by the Value for Money Pilot Program as well as identified gross potential savings / revenues, improvements to operational efficiency and effectiveness, and achieved savings.

Twelve projects have been completed as part of the Value for Money Pilot Program which has led to identifying recurring annual and one-time gross savings / revenues of \$1,298,000 - \$2,048,000 and \$41,000, respectively. Although VFM follow up audits have not been performed on all projects, follow up audits completed as well as operational management reports indicate that at least \$1,346,000 in savings have been achieved. As compared to the \$913,000 spent on the Value for Money Pilot Program since its inception as at December 31, 2016, the Program has recovered more than its own cost in identified savings.

In addition to savings, many other non-financial recommendations were presented as part of the VFM projects completed and audit reports to improve the efficiency and effectiveness of operations throughout the organization, including:

- Implementing electronic funds transfers which may result in more timely payments to City suppliers;
- Eliminating unfair advantages for those businesses that choose to operate without a licence;
- Better utilizing Global Positioning System (GPS) / Automatic Vehicle Location (AVL) systems to manage staff productivity and efficiency;
- Altering the DARTS fleet configuration to increase flexibility, response time and availability of paratransit services at lower cost;
- Creating performance metrics to measure performance and monitor workflow (in the area of claims adjusting);
- Limiting the number of pre-printed agendas available to the public to reduce waste and save 120 trees annually (in the Office of the City Clerk);

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- Creating performance metrics and setting milestone targets to improve Protective Plumbing Program application and payment processing times;
- Developing, designing and implementing a public-facing City dashboard (with respect to performance measures);
- Implementing a triage process to assess new Ontario Works client needs and directing them to the most appropriate Employment Services program;
- Creating policies and procedures related to the use of external consultants, the use of gapping to fund consultants, change orders and contingencies; and
- Developing a reserve strategy with longer term financial plans and targets.

#### Need for VFM Auditing and Other Services

The work of the Audit Services Division encompasses the examination and evaluation of the adequacy and effectiveness of the City's governance, risk management processes, system of internal control structure and the quality of performance in carrying out assigned responsibilities to achieve the organization's goals and objectives. This currently includes conducting VFM audits. Value for money recommendations enable the City's processes to function in a manner that ensures:

- Programs and services are effective in achieving their intended objectives;
- Resources are acquired economically, used efficiently and are adequately protected;
- Quality and continuous improvement are fostered in the organization's control processes;
- Significant financial, managerial and operating information is accurate, reliable and timely; and
- Actions are in compliance with policies, standards, procedures and applicable laws and regulations.

There are other services of equal benefit to the above objectives and which provide a more fulsome capability toward them. An effective modern day approach to audit services incorporates a multiplicity of service offerings that includes providing advice, facilitation, risk assessment and consulting in addition to the core complement of compliance, control and VFM audits. This enables a more balanced approach to providing assurance – one that looks both retrospectively and proactively at issues of risk, governance and control. It takes greater advantage of the skills and experience auditors have, and leverages Audit toward finding solutions and anticipating organization challenges in the future.

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### Audit Rotation Program

One innovation opportunity that has been identified is the establishment of a formal audit rotation program that provides development opportunities for high potential staff to work in Audit Services under the sponsorship of their department.

According to a global Ernst & Young 2013 survey of more than 500 Chief Audit Executives, many audit functions are addressing the skills and competency requirements necessary to fulfil broader mandates that reach beyond compliance activities through innovations in resourcing. According to the study, many audit functions supplement the need for specialized skills and augment their resources through programs referred to as auditor rotation programs. In the survey over 77% of respondents state they have such programs, and of those that do, 50% are formal programs of rotation. The cited benefits include enhanced knowledge sharing and exposure to different businesses and functions, sharing of leading practices, development of new skills, increased awareness and experience with new tools such as risk management. The concept has been successfully implemented at leading organizations such as General Electric and Microsoft.

An audit ongoing rotation at the City would offer a unique development opportunity for staff to gain experience in new disciplines and exposure to different businesses, functions, and practices. It leverages audit as a training ground for financial acumen and controllership, skills in project management, internal control, risk management, performance measures, business analytics and facilitation.

It aligns with the goals of Our People and Performance Plan, and provides resources to enable continued fulfilment of the Audit Work Plan with expanded service offerings, including consulting, value for money, risk management and ethics services that support City strategic priorities.

### **ALTERNATIVES FOR CONSIDERATION**

- 1) Discontinue the Value for Money Pilot Program, incorporate VFM auditing into the duties of the current permanent Audit Services staff complement and implement an Annual Audit Rotation Program.

The two temporary FTE Performance Auditor positions would be eliminated and VFM audits will be carried out by the current permanent staff in the Audit Services Division. As shown in the organizational chart in Appendix “B” to Report AUD17013, the permanent staff complement consists of seven FTEs (one Director, one Supervisor, two Senior Internal Auditors, two Intermediate Internal Auditors and one Administrative Assistant). It is the four Auditor positions that will be primarily responsible for completing VFM audit projects. Audit Services will review roles and



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responsibilities carried out by each Auditor position and re-evaluate compensation levels (if required) to ensure compensation is fair and aligned with these new duties.

The Audit Services Work Plan will continue to include VFM audits as well as compliance audits, consulting engagements, risk assessments, lessons learned / opportunities assessments and developing / implementing a comprehensive fraud prevention and detection program as outlined in the 2016-2018 Audit Services Work Plan (AUD16005). In order to appropriately staff the Division and carry out the Work Plan, Audit Services will implement an Annual Audit Rotation Program to bring two permanent FTE rotational positions to the Division, paid by the employee's home department for one year work terms, to build skills and learn about the organization while contributing to Audit Services' mandate and work plan.

Financial: Additional costs that may stem from reviewing the compensation for current permanent Auditor positions are unknown at this time.

Additional annual levy-based funding for staffing (e.g. training, equipment and supplies) would be required for the Annual Audit Rotation Program and is estimated at approximately \$10,000. The cost of salaries and benefits would be incurred by the employees' home departments.

It is prudent to include an annual budget of \$25,000 to the Audit Services operating budget to allow for the retention of outside consultants in areas for which the Audit Services Division does not have expertise when carrying out VFM audits. Therefore, a \$25,000 annual increase in the operating budget will impact the general levy.

Staffing: Two temporary FTE Performance Auditor positions are eliminated. No levy savings would be realized as these two positions were funded from the Tax Stabilization Reserve.

Two FTE rotational positions added to the Audit Services Division staff complement dependent on departmental funding.

Legal: None.

Pros:

- Lower cost option that allows VFM auditing to continue in the long-term.
- Annual increase to the general levy is minimal compared to other options.
- Provides high-potential candidates across the organization with a unique opportunity to build leadership skills and learn about other business units.

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- Provides resources to avoid cutbacks to the Audit Work Plan

Cons:

- Requires the addition of two rotational FTEs to the complement.
- The resources utilized to train current staff in the value for money program may not be fully utilized.
- Existing staff in the Audit Services Division would require training in VFM auditing.
- Requires time to plan, create and implement the Rotation Program as well as on boarding and training materials.
- The level of work produced by the Audit Services Division may temporarily decline due to implementation of the rotational staff concept.
- Departments may not have the resources to support the Rotation Program.

This is the recommended option. The benefits to the organization far outweigh the costs. VFM auditing will continue to identify opportunities for savings and ways to improve operational efficiency and effectiveness across the organization at minimal cost. The Annual Audit Rotation Program will provide candidates with a unique growth opportunity as well as sustain adequate staffing levels for Audit Services to carry out the majority of the Work Plan.

- 2) Discontinue the Value for Money Pilot Program and incorporate VFM auditing into the duties of the current permanent Audit Services staff complement.

The two temporary FTE Performance Auditor positions would be eliminated and VFM audits will be carried out by the current permanent staff in the Audit Services Division. As shown in the organizational chart in Appendix “B” to Report AUD17013, the permanent staff complement consists of seven FTEs (one Director, one Supervisor, two Senior Internal Auditors, two Intermediate Internal Auditors and one Administrative Assistant). It is the four Auditor positions that will be primarily responsible for completing VFM audit projects. Audit Services will review roles and responsibilities carried out by each Auditor position and re-evaluate compensation levels (if required) to ensure compensation is fair and aligned with these new duties.

The Audit Services Work Plan would continue to include VFM audits or individual project scopes could include VFM components. However the total volume of work of the Division would decrease due to the removal of the two temporary FTE Performance Auditor positions.

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Financial: Additional costs that may stem from reviewing the compensation for current permanent Auditor positions are unknown at this time.

It is prudent to include an annual budget of \$25,000 to the Audit Services operating budget to allow for the retention of outside consultants in areas for which the Audit Services Division does not have expertise when carrying out VFM audits. Therefore, a \$25,000 annual increase in the operating budget will impact the general levy.

Staffing: Two temporary FTE Performance Auditor positions are eliminated. No levy savings would be realized as these two positions were funded from the Tax Stabilization Reserve.

Legal: None.

Pros:

- Lower cost option that allows VFM auditing to continue in the long-term.
- Annual increase to the general levy is minimal compared to other options.
- No permanent or temporary FTEs are added to the complement.

Cons:

- The level of work produced by the Audit Services Division will decline by approximately 33% due to the loss of the dedicated two employees supporting the VFM function.
- The resources utilized to train current staff in the Value for Money Pilot Program may not be fully utilized.
- Existing staff in the Audit Services Division would require training in VFM auditing.

This alternative is not recommended.

3) The two temporary FTE Performance Auditor positions become a permanent part of the Audit Services Division staffing complement when the Value for Money Pilot Program ends on June 30, 2017.

Financial: The Value for Money Audit Program would continue to be funded from the Tax Stabilization Reserve until December 31, 2017. Additional reserve-based funding for staffing (e.g. salaries, benefits, training, equipment and

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supplies) would be required and is estimated at approximately \$141,000 for this 6-month period.

As of January 1, 2018, the Program would be incorporated into the annual operating budget request funded through the general levy. Annualized funding for staffing costs are estimated at approximately \$285,000. Additionally, it is prudent to include an annual budget of \$25,000 to allow for the retention of outside consultants in areas for which the Audit Services Division does not have expertise. Therefore, the total ongoing annualized increase in the operating budget is approximately \$310,000.

Staffing: Two temporary FTE Performance Auditor positions become permanent positions of the Audit Services Division staff complement.

Legal: None.

Pros:

- Provides a dedicated long-term VFM auditing function with the potential to change the organization for the better in the long term.
- The level of work produced by the Audit Services Division will remain the same, enabling full coverage of the Audit Work Plan.
- A permanent solution provides some stability and surety to the resources of the Audit Services Division by increasing the likelihood of reducing turnover and retaining qualified staff for permanent positions.

Cons:

- Requires the addition of two permanent FTEs.
- Will place additional funding pressure on the general levy.

This alternative is not recommended.

- 4) Extend the Value for Money Pilot Program by 21 months with funding to continue from the Tax Stabilization Reserve. An extension would allow sufficient resources to achieve full realization of the Audit Work Plan until the next term of Council. The Pilot Program would be re-evaluated at the end of this extension.

Financial: The extended Value for Money Pilot Program would continue to be funded from the Tax Stabilization Reserve until March 31, 2019.

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Additional funding for staffing (e.g. salaries, benefits, training, equipment and supplies) would be required and is estimated at approximately \$497,000 for the 21-month term. Additionally, it is prudent to include a budget of \$31,000 over the extension period to allow for the retention of outside consultants in areas for which the Audit Services Division does not have expertise.

Therefore, the total one-time incremental cost over 21 months is approximately \$528,000.

Staffing: Two temporary FTE Performance Auditor positions are extended for a 21-month term concluding on March 31, 2019.

Legal: None.

Pros:

- Allows a dedicated VFM auditing function to continue in the short term without the addition of permanent FTEs.
- The level of work will remain consistent in the short term without the addition of permanent FTEs.
- Provides sufficient resources to achieve full coverage of 2016-18 Audit Work Plan
- Will not place additional funding pressure on the general levy.

Cons:

- An extension is a temporary solution which will not bring significant positive long-term benefit to the organization.
- A minimal number of large VFM projects will be undertaken due to the amount of time required to carry out such projects.
- Staffing the Pilot Program for contract positions, as well as related permanent contract positions in Audit Services, has been challenging in the past and is not expected to change in the foreseeable future.

This alternative is not recommended.

**ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN**

**Our People and Performance**

*Hamiltonians have a high level of trust and confidence in their City government.*

**APPENDICES AND SCHEDULES ATTACHED**

Appendix “A” to Report AUD17013 – Summary of Identified Savings and Other Results

Appendix “B” to Report AUD17013 – Audit Services Division Organizational Chart

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