

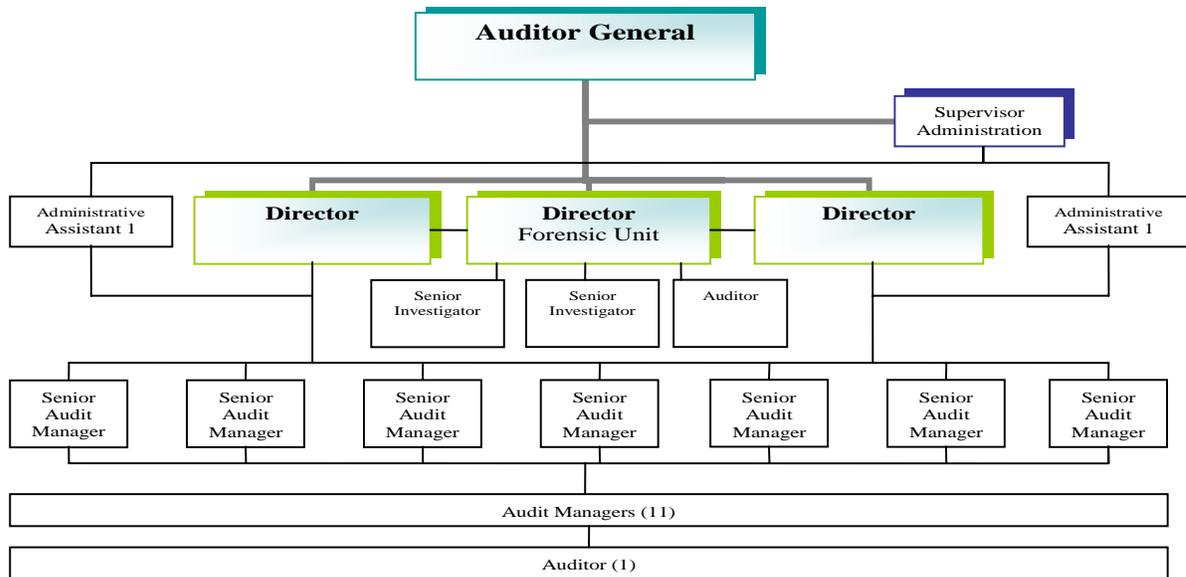
# AUDITOR GENERAL'S OFFICE

## Mission Statement

**To be recognized as a leading audit organization, respected by our clients and peers for excellence, innovation and integrity, in supporting the City of Toronto to become a world class organization.**

Program Profile

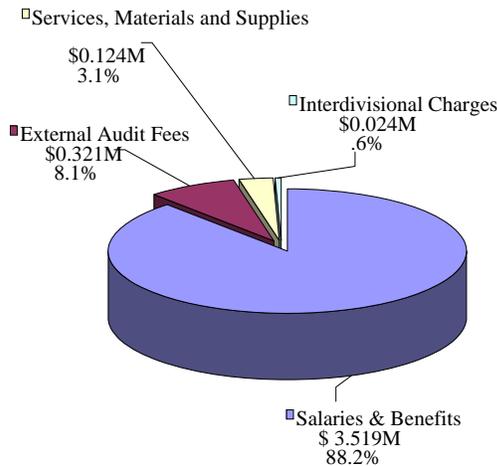
Total Approved Positions = 29



## 2007 Key Strategic Directions and Priorities

- Directing the use of audit resources through the 2007 Audit Work Plan based on a priority setting risk assessment exercise to focus on value for money reviews in those areas which potentially pose the greatest risk or provide the greatest value/return to the City.
- Complete the formal follow-up process for City Local board audit recommendations and the annual follow-up for City divisional audit recommendations from 2006 and prior audit reports.
- Complete a long-term Strategic Staffing plan for the Auditor General's Office to quantify the long-term staffing needs of the Office.
- Secure the external audit services required by the City through the issuance of a request for proposal.
- Coordinate the complaint activity of the Fraud and Waste Hotline with the new role of the Ombudsman created under the City of Toronto Act to eliminate potential overlap of responsibilities.

## 2007 Recommended Operating Budget Total = \$3.988M (Gross and Net)



## 2006 Key Accomplishments

- Completed key priority audit projects over significant operational areas of the City having 179 recommendations to improve controls and benefit the City through savings and reduced costs.
- Implemented and completed the first formal follow-up process to ensure the Auditor General's audit report recommendations to City Divisions, issued since amalgamation, have been appropriately implemented.
- Continued the operation of the City's Fraud and Waste Hotline Program.
- Successfully completed the first external Peer Review of the Auditor General's Office in accordance with *Government Auditing Standards*, the first of its kind by an audit office in Canada.

## 2008 / 2009 Outlook/Challenges

An extremely important component of any audit process is the requirement that there be a follow-up of audit recommendations made. There is little benefit to an audit unless recommendations resulting from the audit are implemented. In order to address this issue, we have, in consultation with the City Manager, set up and implemented a formal process to follow-up on all previously issued audit reports on an annual basis. The resources devoted to this process have been significant. Nevertheless, the process is now part of our annual work plan and it will enable us to ensure that all previously approved recommendations have been implemented. *Government Auditing Standards* have also continually evolved raising auditing standards and presenting challenges to meet these higher expectations through our own rigorous polices and peer review processes.

One question repeatedly asked of the Auditor General by members of the Audit Committee is whether or not the Auditor General has sufficient resources to adequately audit the City and its Agencies, Boards and Commissions. To answer this question, the Auditor General is presenting a strategic plan to Audit Committee in the spring of 2007. This document will provide various options for the level of auditing appropriate for the City.

In addition, the activity relating to the Fraud and Waste Hotline has increased significantly since its inception in 2002. It was recognized and acknowledged that during its initial phase, the Hotline could be accommodated with existing resources until the extent of activity was

determined. In 2006, with the approval of Council, we added one position to deal with the workload created by the Fraud and Waste Hotline. The long-term staffing levels of this dedicated Forensic Unit will be addressed in the strategic plan being presented to Audit Committee in the spring of 2007.

### The Benchmarking of Audit Costs – Comparisons with Other Municipalities

The Auditor General’s Office has benchmarked its costs with those of major municipalities across Canada, as well as those of a number of municipalities in the United States. The following comparison of costs with other major municipalities for comparable levels of audit services indicates that, as a percentage of total municipal budgets, the audit costs at the City of Toronto are at the lower end of the scale. As it is not possible to obtain most of the budget numbers for 2007, the majority of costs in this table relate to the 2006 fiscal year.

|                                            | Municipal<br>Operating Budget<br>(in \$000s) | Audit Costs<br>(in \$000s) | Audit Costs as a<br>% of Municipal<br>Operating Budget |
|--------------------------------------------|----------------------------------------------|----------------------------|--------------------------------------------------------|
|                                            | \$                                           | \$                         | %                                                      |
| <b>City of Toronto</b> (1) (2007 Estimate) | <b>8,200,000</b>                             | <b>5,577</b>               | <b>0.07</b>                                            |
| City of Ottawa                             | 2,114,000                                    | 1,699                      | 0.08                                                   |
| Calgary                                    | 2,300,000                                    | 1,618                      | 0.07                                                   |
| Edmonton                                   | 1,310,000                                    | 1,781                      | 0.14                                                   |
| Winnipeg                                   | 1,092,000                                    | 1,066                      | 0.10                                                   |
| Los Angeles County                         | 17,127,000                                   | 15,000                     | 0.09                                                   |
| Philadelphia                               | 6,461,000                                    | 7,101                      | 0.11                                                   |
| Detroit                                    | 2,821,000                                    | 2,358                      | 0.08                                                   |
| Phoenix                                    | 2,447,000                                    | 3,677                      | 0.15                                                   |
| San Jose                                   | 1,503,000                                    | 1,989                      | 0.13                                                   |

(1) Excluding TTC

The audit costs for the City of Toronto in the amount of \$5,577,000 reconciles to the 2007 requested budget as follows:

|                              |                    |
|------------------------------|--------------------|
| 2007 Requested Budget        | \$3,988,443        |
| Less External Audit Fees     | (320,755)          |
| Add Internal Audit Functions | <u>1,909,709</u>   |
| Audit Costs – Table 2        | <u>\$5,577,397</u> |

Of significance in the comparison of audit costs between municipalities is current legislation in Quebec. The *Quebec Cities and Towns Act* in Section 107.5 requires that, “The budget of the municipality shall include an appropriation to provide for payment of a sum to the chief auditor to cover the expenses relating to the exercise of the chief auditor’s duties.” The amount legislated for audit services in municipalities with a budget in excess of \$1 billion is 0.11 per cent of the total City budget.

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If the equivalent percentage of 0.11 per cent was applied to the City of Toronto, the City's total audit budget would be in the range of \$9 million.

The 2007 requested audit budget at the City is as follows:

|                          |                           |
|--------------------------|---------------------------|
| Auditor General's Office | \$3,988,443               |
| Internal Audit Functions | <u>1,909,709</u>          |
|                          | <b><u>\$5,898,152</u></b> |

Using the Quebec model as a guide, it would not be unreasonable to suggest that the audit budget at the City should increase by approximately \$3.1 million. We are not suggesting that such an increase be considered without significant additional deliberation or analysis, nor are we suggesting that these additional resources be exclusively allocated to the Auditor General's Office. For example, any increase to the audit budget at the City should also consider the needs of the Internal Audit Division operating out of the City Manager's Office.

The above analysis does, however, demonstrate that audit resources at the City are not excessive and likely should be increased to a level commensurate with the size of the City. We are developing a long-term strategic staffing plan for the Auditor General's Office. This particular plan is addressing the issue of long-term resources along with the frequency of priority audits over the next number of years.

### **Program Overview**

In May 2002, City Council approved an independent Auditor General's Office for the City of Toronto in conjunction with the implementation of a new audit framework. The *City of Toronto Act*, 2006 has subsequently formalized the establishment of the Auditor General. Section 177 of the new Act requires that "The City shall appoint an Auditor General".

The 2002 audit framework established three levels of audit services for the City of Toronto.

- (1) The Auditor General's Office was created in order to report directly to and provide assurance strictly for City Council. The new *City of Toronto Act*, 2006 has not changed this requirement.
- (2) A separate Internal Audit Division was established to provide assurance for the City's Executive Management Team. While the establishment of an Internal Audit function is not a legislative requirement, it does represent best practice and is consistent with practices in other large government organizations. The Internal Audit Division reports to the City Manager and is responsible for providing internal audit services and support to senior management in the City. The internal audit function provides impartial and objective assurance; consulting services designed to improve the administration of municipal operations; and promotes compliance with City policies and procedures.

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- (3) Finally, as required by previous legislation and the *City of Toronto Act, 2006*, an external auditor is appointed by City Council to perform the annual statutory audit of the City's financial statements and provide an opinion on the fairness of the information presented in these financial statements.

Section 139 (3) of the *City of Toronto Act, 2006* states that "the city auditor shall not be a city employee or an employee of a local board of the city". Also in accordance with the Act, the auditor shall not be appointed for a term exceeding five years. An external public firm of practising accountants, Ernst & Young LLP, is responsible for the financial audits of the City and various City entities for fiscal years 2003 to 2007. The accounting firm of Grant Thornton LLP conducts the annual statutory audits of the Boards of Management of Community Centres and Committees of Management for Arenas. The Auditor General is responsible for issuing the request for proposal to secure the external audit services required by the City and maintains an oversight role for these statutory audits.

### **Mandates and Responsibilities**

The Auditor General is responsible for carrying out financial (excluding attest), compliance and performance audits of all programs, activities and functions of all City divisions, the offices of the Mayor and members of Council, local boards (restricted definition) and City-controlled Corporations.

The mandate empowers the Auditor General to:

- (a) conduct or cause to be conducted operational audits, defined as evaluating the management of public funds and resources from a standpoint of economy, efficiency and effectiveness, and making recommendations on operating improvements;
- (b) examine and evaluate the adequacy of the City's policies and systems of internal control, both financial and operational;
- (c) evaluate the procedures used by management to measure and report on program effectiveness. This includes an evaluation of the results or benefits achieved, and whether the programs or activities are meeting established objectives of providing value-added services to the City businesses, tax payers and residents;
- (d) conduct special assignments identified by the Auditor General, or approved by a two-thirds majority resolution of Council;
- (e) conduct forensic investigations including suspected fraudulent activities, waste and misuse of City resources;
- (f) provide assurance that the information technology infrastructure contains adequate controls and security including business continuity (emergency) planning;

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- (g) oversee the work and the contract of the external auditors performing financial statement/attest audits;
  - (h) coordinate audit activities with internal auditors and any contracted work to ensure the efficient and effective use of audit resources; and
  - (i) manage the Fraud and Waste Hotline Program, including the referral of issues to divisional management and the Internal Audit Division.

### **Access to Records by the Auditor General**

The Auditor General has complete and full access to any records within the City; including local boards (restricted definition) city controlled corporations or grant recipients as the case may be. Staff of organizations within the Auditor General's scope has a duty to co-operate with the Auditor General and to not obstruct audit activities.

### **The Impact of the *City of Toronto Act***

The *City of Toronto Act* states, in Section 178 (3) under Powers and Duties of the Auditor General's Office, that "the Auditor General may exercise the powers and shall perform the duties as may be assigned to him or her by city council in respect of the City, its local boards (restricted definition) and such city controlled corporations and grant recipients as city council may specify." Under the *City of Toronto Act* "local boards (restricted definition)" is defined as a local board other than the Toronto Police Services Board, the Toronto Public Library and the Toronto Board of Health.

In essence, the Auditor General of the City of Toronto, under the new legislation, has no authority to access records or conduct audit work at those "restricted" local boards.

However, City Council has approved that the Auditor General, at his discretion, may undertake financial (excluding attest) compliance and performance audits of the "restricted" local boards upon request by the boards. Further, at the two-year review of the *City of Toronto Act*, amendments to the Act have been proposed to include the "restricted" boards in those entities subject to audit by the Auditor General.

### **The Role of the Ombudsman under the *City of Toronto Act***

Under Section 171 of the *City of Toronto Act* "the function of the Ombudsman is to investigate any decision or recommendation made or any act done or omitted in the course of the administration of the City, its local boards (restricted definition) and such city-controlled corporations as city council may specify and affecting any person or body of persons in his, her or its personal capacity."

We have had preliminary discussions with the City Manager's Office, particularly, in the context of the potential overlap of responsibilities as it relates to various complaints received by the Auditor General on the Fraud and Waste Hotline. We will continue these discussions with

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management but, based on initial discussions, any complaints received on the Fraud and Waste Hotline which are considered “ombudsman related” are currently referred to management by the Auditor General’s Office.

### **Program Objectives for 2007**

The Auditor General, in addition to the development of a risk-based Audit Work Plan, has developed the following objectives for 2007:

1. Ensure that adequate organizational supports and quality assurance measures are in place for ongoing successful peer reviews of the Auditor General’s Office;
2. Participate as team members in conducting external quality assurance peer reviews of other government audit offices;
3. Complete and report on the formalized follow-up process related to recommendations made in prior audit reports with respect to Agencies, Boards and Commissions. This systematic formal follow-up process will be completed annually as part of the Annual Audit Work Plan to ensure timely follow-up to audit recommendations;
4. Ensure that communication and coordination of audit resources with the external auditors to ensure efficient and effective use of these resources. In 2007, the Auditor General’s Office will issue a Request For Proposal to initiate a new service agreement for external audit services for a five year period to commence in 2008;
5. Communicate with other entities including restricted local boards, Toronto Police Services, Toronto Public Library, Toronto Board of Health and other entities such as the Toronto Transit Commission to monitor issues and audit work that impacts the City;
6. Increase the use of information technology by staff in carrying out audits. Such technology to include the use of the data extraction program called ACL. Continue to communicate with other North American audit organizations that operate ACL in order to maximize the value of the program to the audit process;
7. Implement a proactive process to identify key “red flags” for the detection of potential fraud or abuse, which will lead to the implementation of reports to be run on a regular basis to provide early identification of potential fraud or abuse;
8. Ensure that all Auditor General’s Office staff have the necessary technical and management skills as well as a knowledge of City operations, to effectively carry out their duties and responsibilities;
9. Through various training opportunities, keep current with issues related to auditing, accounting or other fields related to the program areas that are subject of review;

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10. Ensure that all staff attain at least 80 hours of training and continuing education over a two-year period, in accordance with *Government Auditing Standards*;
  11. Encourage and support Audit staff in obtaining professional designations in specialized audit fields related to environmental auditing, fraud investigations or information technology;
  12. Provide ongoing input to the revised Auditor General's Policies and Procedures Manual and implement formalized guidelines for conducting audit investigations including standard working papers specific to the needs of the Forensic Unit;
  13. Maintain and update the Auditor General's Web site in order to ensure that it continues to be rated as one of the best audit web sites in North America; and
  14. Establish and maintain links and associations with various municipal audit executives within Canada and throughout the United States.

### **Values and Professional Audit Standards**

The audit process is an independent, objective assurance activity designed to add value and improve an organization's operations. The audit process assists an organization in accomplishing this objective by bringing a systematic, disciplined approach in evaluating and improving the effectiveness of risk management, control and governance processes.

The Auditor General's Office conducts its work in accordance with *Government Auditing Standards*. Audits are conducted in accordance with these standards, which relate to independence, objectivity, professional proficiency, scope, performance of work, and divisional management. Staff is also bound by the professional standards, values, attitudes and ethics of their respective professional organizations, which include the Institute of Chartered Accountants of Ontario, the Certified General Accountants Association, the Society of Management Accountants, the Information Systems Audit and Control Association, the Association of Certified Fraud Examiners and the Canadian Environmental Auditing Association.

All non-administrative members of the Auditor General's Office have at least one professional designation and many continually upgrade their skills through ongoing training and specialization such as the Certified Fraud Examiner designation.

The level of proficiency and professional standards maintained by the Auditor General's Office exemplifies the City's values and vision. The Office is committed to ensuring the City delivers value added services by improving controls, policies and procedures to increase economy, efficiency, and effectiveness. In addition, the ongoing fraud monitoring and control function implemented by the Auditor General's Office has created a deterrence to unacceptable behaviour through awareness that fraud and waste behaviour has a high probability of being detected.

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## **Peer Review**

One requirement of *Government Auditing Standards* is that audit organizations undergo an independent external peer review at least once every three years. The objective of a peer review is to determine whether an audit organization's internal quality control system is in place and operating effectively. A peer review provides assurance that established policies and procedures and applicable auditing standards are being followed.

The Auditor General's Office underwent its first peer review during 2006. No other audit office in Canada has undergone such a process. Two reports were issued by representatives from the Association of Local Government Auditors on the results of this review concluding the Auditor General's Office had met the requirements of *Government Auditing Standards*.

## **Annual Audit Work Plan and Budget**

The Auditor General submits an Audit Work Plan each year to Council through the Audit Committee, and in accordance with the Auditor General's by-law, no deletions or amendments to the Audit Work Plan can be made, except by the Auditor General. Council may only add to the Audit Work Plan pursuant to a two-thirds majority vote.

The 2007 Audit Work Plan for the Auditor General's Office recognizes the fact that resources for auditing are limited and it is necessary to use risk assessment to prioritize audits. The 2007 Audit Work Plan also considers the work to be performed by the Internal Audit function reporting directly to the City Manager and the work to be conducted by the respective audit groups at other City entities. In addition, the Auditor General consults with the external attest auditors of the City and its local boards (restricted definition) and considers any issues identified during their attest audits that may impact our planned audit process.

The 2007 Audit Work Plan for the Auditor General's Office is based on the results of a Corporate-wide risk assessment and priority setting exercise. The risk assessment assists in directing the use of audit resources to provide the greatest value/return to the City by focusing on those areas that potentially pose the greatest risk for the City. The risk assessment includes several risk factors such as the magnitude of gross expenditures and revenues; political and public sensitivity; legislative requirements; complexity of the operation; and system of internal controls.

Although the primary objective is to complete the projects set out in the 2007 Audit Work Plan, the Auditor General also recognizes the need to shift resources and priorities in response to changing needs, issues and risks within the City. The goal of the Auditor General's Office is to provide maximum value to the City

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## **Benefits of an Effective Audit Process**

An effective audit process can result in a significant payback to the City in terms of:

- increased revenues;
- reduced costs;
- improved internal controls;
- operational efficiencies; and
- enhanced protection of City assets.

The costs savings generated by the Auditor General's Office since amalgamation, while difficult to quantify precisely, have been significant and far outweigh the costs to operate the office. Many of the savings generated are not one-time savings as in many cases they represent ongoing annual savings.

During 2006, the Auditor General's Office generated approximately 179 recommendations in various audit reports and other communications to senior management of the City. Certain of these recommendations have resulted in improved internal controls, and enhanced protection of the City's assets. The potential economic impact of these specific recommendations to improve internal controls is not quantifiable.

Other recommendations have resulted in the potential for increased revenue and also for the reduction of costs. In many of these cases, it is difficult to quantify savings to the City particularly those relating to fraud investigations. For instance, while certain investigations have identified quantifiable losses the extent of the future losses would have been much more significant if such frauds had remained undetected for a significant period of time.

In a report to Audit Committee dated February 7, 2006 entitled "Auditor General's Audit Reports - Benefits to the City of Toronto – Annual Update", it was reported to Audit Committee that the actual potential net savings (after accounting for the annual budgets of the Office) for the period 1999 to 2005 were in the range of \$30 million. At the request of the Audit Committee, this report will be updated and tabled with the Committee during the first quarter of 2007.