

**Solid Waste Management Services –  
Review of Major Contracts**

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**February 9, 2007**

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 **TORONTO** Auditor General

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# **SOLID WASTE MANAGEMENT SERVICES – REVIEW OF MAJOR CONTRACTS**

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## **EXECUTIVE SUMMARY**

Over the past 12 months, the Auditor General has issued two audit reports outlining concerns in connection with the way the City manages certain major construction contracts. Recommendations contained in the two reports focused on areas requiring improved operational effectiveness, controls over contract management processes and contract payment procedures.

This review focused on procedures carried out by the Solid Waste Management Services Division in contract management and processing of payments.

The Solid Waste Management Services Division manages a significant number of major contracts for purchases of goods and services. Many of them are long-term contracts with complicated payment terms and service specifications.

Our review found that divisional staff is clearly committed to ensuring that contractors deliver uninterrupted services according to service levels, criteria and payment terms under various contracts. The four major contracts examined have an annual gross value of \$57.4 million and revenues of \$5.5 million. While we identified a number of concerns and improvement opportunities in this report, it is important to note that considering the complicated terms and conditions covered and numerous new initiatives introduced to the City's waste collection, recycling and processing programs over the past few years, these contracts were reasonably well managed.

However, because project managers rely on their professional experience and discretion in managing contracts which usually have numerous conditions and requirements, certain control procedures were not performed as well as they should, and non-compliance with some contract conditions was overlooked. The challenge facing the Solid Waste Management Services Division is to ensure that its contracts include conditions and requirements that are realistic, practical and enforceable. We found that for various operational reasons, contract conditions were not always enforced.

Issues identified during our review and opportunities for enhanced management controls in administering City contracts are outlined in detail in the balance of this report and include the following:

- Our review found an error in the accounting for revenues and processing costs and a number of potential minor invoice overpayments. Based on our analysis and discussion with staff, the accounting error has no net financial impact and the potential overpayments are insignificant. Nevertheless, controls should be strengthened to ensure such potential overpayments are not possible.
- Critical specifications included in two contracts were not monitored for compliance in a timely and effective manner.
- We noted instances where City procurement policies and procedures were not followed and financial signing authority limits were exceeded. Clear communication of corporate policies and strengthened management controls, combined with purchasing procedure changes which allow divisions to operate efficiently, will promote compliance.
- Financial guarantees, such as performance bonds and letters of credit, have not been kept up to date, resulting in a risk to the City in the event of non-performance by a contractor.
- Finally, the City does not apply a consistent approach to ensure that various contractors follow requirements under the *Occupational Health and Safety Act* and Workplace Safety and Insurance Board.

Addressing the recommendations in this report will help strengthen management controls, improve quality assurance management and enhance the overall efficiency of payment and contract management processes.

## **BACKGROUND**

The Auditor General's 2006 Audit Work Plan included a review of major contracts administered by the Solid Waste Management Services Division. This review was selected based on criteria such as potential for City liability, the extent of expenditures, revenues and assets and other emerging issues of concern.

The Solid Waste Management Services Division operates seven transfer stations, six household hazardous waste depots, two blue box materials recovery facilities, an organic processing facility, 13 maintenance and operating yards, as well as closed former landfill sites. The Division also manages several waste diversion programs including the Clean City Litter Program, source separated organics collection and processing, environment days, backyard composter distribution, recovery of household hazardous waste, and tire and white goods recycling.

With a total of 1,422 approved positions in 2005, the Solid Waste Management Services Division incurred gross expenditures totalling \$216 million and generated revenue totalling \$58 million. Contracted services make up about 43 per cent of the divisional operating costs while in-house staff costs account for approximately 39 per cent.

## **AUDIT OBJECTIVES, METHODOLOGY AND SCOPE**

The objective of this review was to assess the extent to which proper management controls were in place to ensure that contracted services were delivered according to established specifications, performance criteria, regulatory requirements, agreed costs and that the City's interests were adequately protected at all times.

This review covered the period from January 1, 2005 to June 30, 2006 and included a review of four major contracts managed by the Division.

The scope of this review did not include an assessment of activities carried out at City transfer stations for issuing weigh scale tickets and recordkeeping. Our evaluation of the information system was limited to examining management controls over the accurate accounting of weigh scale tickets for invoice payment and revenue billing purposes.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit methodology included a review of policies and procedures, interviews with relevant City staff, site visits, examination of documents and records, evaluation of current management control processes, review of relevant Council, Standing Committee and audit reports, analysis of data and any other procedures deemed appropriate.

## **AUDIT RESULTS**

### **Background**

Our review included an evaluation of internal controls and procedures applied by the Solid Waste Management Services Division in managing four major contracts. These contracts were selected because of their significant contract value, lengthy time period covered, and risk exposure.

The following contracts were selected for detailed examination.

1. An agreement with Canada Fibers Ltd. for processing recyclables at the City's Dufferin Material Recycling Facility. This seven-year agreement, at an estimated processing cost of \$5.7 million annually, covers the period from 2006 to 2012. Estimated sales revenues from recovered fibre and container materials are approximately \$5.5 million a year.

2. A two-part agreement with Republic Transportation Services of Canada, Inc. for hauling and disposing waste from City transfer facilities. The contracts, with renewal options, could run until 2020. The combined annual budget for both haulage and disposal is approximately \$45 million.
3. A City contract with Turtle Island Municipal Services Inc. for collecting curbside waste, bulky items, yard waste, recyclables, and commercial waste and recyclables in the Etobicoke district and delivering these collected materials to City transfer and processing facilities. The contract is for \$6 million a year and covers the period from September 2002 to June 2008, with the option to extend for two additional years.
4. A contract with Buckham Transport Ltd. for removing household hazardous waste from City depots and for emergency response to spillage of hazardous waste. This contract, with a quoted price of \$0.7 million, originally covered the period from January 2004 to December 2004. Divisional management has exercised its option and extended the contract to December 2006. A different vendor has been contracted for delivering household hazardous waste removal services in 2007.

Audit results are detailed in the following sections.

**A. MANAGEMENT CONTROLS ON PROCESSING CONTRACT  
PAYMENTS REQUIRE IMPROVEMENTS**

Our review found an error in the accounting for revenues and processing costs and a number of potential minor invoice overpayments. Based on our analysis and discussion with staff, the accounting error has no net financial impact and the potential overpayments are insignificant.



### **A.1. Errors in Reporting Revenues, Processing Costs and GST on Purchases and Sales**

Under the contract for processing recyclables at the Dufferin Material Recycling Facility, the contractor also purchases from the City all recovered fibre materials according to a published market price (known as the Official Board Price Index) plus a fixed price premium. Over the past number of years, staff recorded the price premium as a reduction of processing costs, instead of sales revenues as required under generally accepted accounting principles. Although there is no net error in the City's financial records as a result of this accounting treatment, both processing costs and sales revenues have been under-reported by approximately \$1.26 million annually.

The City also has a contractual arrangement with Metro Waste Paper Recovery Inc. for processing recyclables in the Scarborough district. While we did not examine that contract in detail, we noted a similar accounting treatment, totalling \$1.5 million annually, in recording related processing costs and sales revenues.

The accounting problems noted above have also caused the City to report incorrectly on its Goods and Services Tax (GST) Returns. Instead of applying GST on gross processing costs and sales revenues, as prescribed by reporting guidelines published by the Canada Customs and Revenue Agency, staff erroneously applied GST on processing costs net of price premium from sales.

The Office of the Treasurer has advised that although GST Returns were incorrectly completed in prior years, the mistake has no financial impact on the City as the net tax was recorded correctly. We were also assured that divisional staff would take steps to correct corporate financial records and GST Returns.

**Recommendations:**

- 1. The General Manager, Solid Waste Management Services, take steps to correct corporate financial records and Good and Services Tax Returns, so that processing costs, sales revenues and Good and Services Tax amounts on operating results of City contracts with Canada Fibers Ltd. and Metro Waste Paper Recovery Inc. are recorded according to generally accepted accounting principles and tax reporting guidelines.**
- 2. The Deputy City Manager and Chief Financial Officer, ensure relevant City staff is aware that purchase and sale transactions with individual customers or suppliers may not be netted against each other but must be recorded in the City's financial records at gross amounts.**

**A.2. Lack of Supporting Documentation for Waiving Provincial Retail Sales Tax**

Our review found that the Division did not obtain a provincial tax exemption certificate from three of its 10 regular purchasers of recyclables before waiving retail sales tax on their purchases from the City. Due to the fact that certain sales revenues were netted against processing costs, as described earlier in this report, relevant data is not readily available for us to quantify the provincial retail sales tax omitted from sales transactions.

Tax regulations require businesses to apply for provincial tax exemption status, or they pay the applicable tax and file for a tax refund later. If a provincial review found that the City did not collect retail sales tax from vendors who do not have tax exempt status, the City could be liable for retail sales tax not remitted from those sales transactions.

Staff training on tax issues and proper management oversight would have avoided the above mistakes.

**Recommendations:**

- 3. The General Manager, Solid Waste Management Services, obtain the required provincial tax exemption certification from all purchasers of recyclables, and take steps to recover provincial retail sales tax on previous sales transactions from customers without a valid provincial tax exemption certificate.**
- 4. The General Manager, Solid Waste Management Services, ensure staff is adequately trained on retail sales tax issues and proper management oversight on sales transactions.**

**A.3. Controls Over Dump Authorization Slips Need to Be Strengthened**

Current invoice review procedures leave the City open for paying for some minor services not covered in the contract for waste collection in Etobicoke. The City could be over billed due to inadequate controls over the use of dump authorization slips. These authorization slips are issued periodically by divisional staff to pre-authorize the contractor's unscheduled use of rental or spare vehicles to handle seasonal peak collections. However, these authorization slips do not have unique serial numbers or other controls to prevent or detect unauthorized document reproduction. The number of authorization slips issued were also not tracked and reconciled to slips remitted at weigh scale stations. As a result of these control deficiencies, the City may be paying for material that does not relate to City business.

Based on evidence obtained in our review, we conclude that payment concerns noted above, if left unattended, could result in the City paying for waste collection services that do not relate to City business. Although there is no risk of significant financial loss, these control weaknesses can be easily remedied to prevent even minor inappropriate payments.

**Recommendation:**

- 5. The General Manager, Solid Waste Management Services, strengthen management controls over the issuance and use of dump authorization slips. Such controls should include the use of unique serial numbers and regular reconciliation of dump tickets issued and remitted at weigh scale stations.**

**B. CONTRACT REQUIREMENTS SHOULD BE ENFORCED**

Our review identified that results of audits of actual recyclable recovery rates at the Dufferin recycling operation were not communicated to the contractor and, management could be more vigorous in enforcing compliance with performance standards under the contract for waste collection in Etobicoke.

**B.1. Procedures in Monitoring Recovery Rate of Recyclable Materials at the Dufferin Material Recycling Facility Require Improvement**

According to the contract, the contractor must process each recyclable material type such that a certain percentage of the material is recovered. If actual performance exceeds the required recovery rates, the contractor will receive a financial incentive. If expected recovery rates are not achieved, the contractor will pay a penalty. Financial incentives or penalty costs, according to the contract, should be calculated and paid every six months.

For example, the contractual recovery rate for aluminum beverage cans is 97 per cent. If staff determine that the facility has received 1,000 tons of potentially recoverable aluminum cans, and that 99 per cent of them were recovered, the contractor would receive a financial incentive equal to revenue from selling the extra 2 per cent (or 20 tons) of aluminum material recovered. However, if staff determine that the contractor has only recovered 94 per cent of the 1,000 tons of aluminum material collected, then the contractor has to pay a penalty. The penalty cost, in this case, is equal to 3 per cent (or 30 tons) in lost sales, plus fees which the City has to pay for disposing 30 tons of aluminum cans as waste at the landfill.

According to the contract, divisional staff is required to randomly examine the content of the items not recovered for potentially recoverable materials, and the contractor should be invited to participate in this exercise. In addition, recovery rates should be calculated monthly for determination of the financial incentive and/or penalty once every six months.

The facility has been in full operation since January 2006, but divisional management has not yet calculated the actual monthly material recovery rates to allow a determination of whether the City should charge certain financial penalties or pay incentives under the contract. Currently, divisional staff checks the waste content for potentially recoverable materials every other week. However, management was unable to provide evidence that the contractor or designate was invited to be present when staff collected the required data. No further analysis has been done on the data collected from the above exercise to determine the actual material recovery rate for communication to the contractor and divisional management.

**Recommendation:**

- 6. The General Manager, Solid Waste Management Services, ensure material recovery rates for the Dufferin recycling facility are calculated, communicated to the contractor each month and appropriate action taken.**

**B.2. Effectiveness of Enforcement Efforts Requires Re-evaluation**

In our review of correspondence, we noted that divisional management were requested to resolve a number of performance-related issues with the contractor for waste collection in Etobicoke, particularly at the start of the contract period in 2002. The City's concerns were communicated through frequent discussions with the contractor and significant improvements have been made, but not all reported performance problems have been fully resolved.

To date, the City has not exercised its right and penalized the contractor for unsatisfactory service performance. According to the contract, the City has the right to charge liquidated damages according to established performance criteria and specific rates if performance problems are not resolved.

Our review of 2006 records showed that the contractor was occasionally late in completing waste collection in Etobicoke. Daily reports to the City only note the overall completion time of the contractor's fleet, rather than completion time by each collection vehicle. As a result, there is insufficient information for management to impose contract penalties for untimely service delivery.

Divisional management has advised that they lack staff resources to monitor compliance with all contract specifications. They also indicated that enforcement of certain contract specifications may have significant operational implications, and that service level has improved since mid 2006. While there are some merits in management's action, there should be compliance with specifications included in contracts. Where there is non-compliance with contract terms, reasons should be documented on file and approved by senior divisional management.

Contract performance problems need to be addressed in a timely and effective manner. In order to ensure that residents receive quality City services, divisional management must develop effective measures to ensure that services are delivered according to contract specifications.

**Recommendation:**

- 7. The General Manager, Solid Waste Management Services, ensure all specifications contained in contracts are clear and enforceable. In unusual circumstances where there is a need to deviate significantly from contract specifications, reasons for such deviations be documented and approved. In circumstances where certain specifications are considered too impractical and likely unenforceable, such specifications be reviewed and, where appropriate, amended.**

**C. CITY POLICIES AND PROCEDURES SHOULD BE FOLLOWED**

Our review found instances of non-compliance with corporate purchasing and financial control policies and procedures in the areas noted below:

- Recycled aluminum products, totalling approximately \$1 million in 2006, were sold to a vendor without following the City's formal quotation process (although the division did obtain three quotes). Divisional staff maintain that existing formal procedures are inadequate to meet their operational needs.
- In one divisional unit, invoices over \$50,000 were approved by a manager who does not have such approval authority. According to divisional policy, a manager has the authority to approve invoice payments of amounts up to \$50,000.

**Recommendations:**

- 8. The Deputy City Manager and Chief Financial Officer, in consultation with the Deputy City Manager responsible for Solid Waste Management, review purchasing policies and procedures to ensure that they are adequate to meet divisional needs to respond to market conditions relating to the sale of materials recovered through the City's recycling facilities.**

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| <p><b>9. The General Manager, Solid Waste Management Services, provide necessary training, such that staff understand and comply with City purchasing and financial control policies, procedures and guidelines.</b></p> |
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**D. PROCESSES CAN BE IMPROVED AND STREAMLINED TO ENSURE THE CITY'S INTERESTS ARE PROTECTED**

All City tender documents and contracts contain a section stating the contractor's obligation to comply with all laws, acts and regulations. In most cases some, or all, of the following are required: performance guarantees; certificate of insurance; certificate of clearance issued by the Workplace Safety and Insurance Board; and a signed statutory declaration (Occupational Health and Safety). These instruments are requested by the City to protect it from claims, risks and losses in connection with activity performed by the contractor under the contract.

Our analysis found that the City requests contractors to provide different levels of assurance for health and safety concerns, even though services under various contracts have similar risk exposures. It should be noted that in all cases there were contractual indemnities that afforded the City some protection against claims for Occupational Health and Safety risks. There is also a lack of clarity on how compliance with the assurances given should be monitored during the contract term. The City needs a framework that ensures that performance and financial guarantees requested of City contractors are reasonable, and that the City is adequately protected during the contract term.



Our observations are detailed below.

**D.1. Efforts in Ensuring Compliance with the *Occupational Health and Safety Act* Need to Be Improved**

The City currently requires contractors to provide different degrees of assurance relating to compliance with the *Occupational Health and Safety Act* and its Regulations. For example, the only requirement in two of the four contracts was that the contractors take all reasonable precautions to comply with the *Occupational Health and Safety Act* and its Regulations. In another contract, the contractor has to submit a signed statutory declaration, Occupational Health and Safety, and the City will monitor to ensure compliance with all applicable Health and Safety Regulations. In the fourth contract, the City only expects to receive minutes for all health and safety training sessions provided to the contractor's staff. Since activities carried out under all these contracts have high health and safety risks, the City should demand a similar level of assurance from all four contractors.

**D.2. Administrative Controls over Performance Bonds and Insurance Certificates Require Strengthening**

While the City requires all its contractors to submit a current certificate of insurance and a performance bond or letter of credit, the City is not adequately protected from potential liabilities because of the following control deficiencies.

- (a) Instead of requiring contractors to complete the City's standard Certificate of Insurance form, other forms of insurance certificate designed by private insurance brokers were accepted. These forms do not always include certain clauses which are specifically designed by the City to protect its interests.

- (b) According to the Toronto Municipal Code, Financial Control By-law Chapter 71-13, duly executed copies of all agreements, including all insurance and certificates, all contracts, bonds, letters of credit and other securities, and all other documents executed by or on behalf of the City shall be delivered to the Chief Financial Officer for safekeeping. Despite this provision, practice is that, in some cases, performance bonds are kept by divisional contract administrators. These administrators are not always aware of their responsibilities with respect to performance bonds. In one of the contracts we examined, there was no valid performance bond for the final two years of a three-year contract. Divisional staff indicate that written guidelines, staff training and management controls would help clarify corporate expectations and ensure City divisions properly manage all performance guarantees and insurance certificates.

### **D.3. Submission of WSIB Clearance Certificates with Contract Payments**

While two out of the four contracts we reviewed required submission of a Workplace Safety and Insurance Board (WSIB) clearance certificate with either each invoice payment or quarterly, the required certificates were not submitted. The purpose of a clearance certificate is to provide financial protection for companies, such as the City, who hire contractors and subcontractors to perform work. Section 141 of the *Workplace Safety and Insurance Act*, 1997 allows for the WSIB to charge the City for the contractor's unpaid WSIB premium.

Currently, a requirement that the contractor provide WSIB clearance certificates varies from contract to contract. We were advised that the Purchasing and Materials Management Division, in ensuring that staff fully understand the City's potential WSIB-related liabilities in engaging private contractors, has planned to invite WSIB representatives to a training session for responsible City staff in 2007.

**Recommendations:**

- 10. The City Manager, in consultation with the Deputy City Manager and Chief Financial Officer and the City Solicitor, review and take necessary steps to ensure contract provisions related to Workplace Safety and Insurance Board clearance certificates, and compliance with the *Occupational Health and Safety Act* are appropriate and consistently included in City contracts with similar risk exposure.**
- 11. The Deputy City Manager and Chief Financial Officer, in consultation with the other Deputy City Managers and the City Solicitor:**
  - (a) review the appropriate standard content of performance bonds and insurance certificates and the appropriateness and criteria for deviations from such standards in light of relevant risk exposure, including the respective roles of the Legal Services Division and Corporate Finance's Insurance and Risk Management section in deciding on any deviation of submitted documents;**
  - (b) review and take necessary steps to ensure current administrative policies and procedures, including clarifying the roles and responsibilities of City Finance and City divisions in the safekeeping, recordkeeping and administration of performance bonds, letters of credit, and insurance certificates, are effective in protecting the City from claims, risks and losses in connection with activities performed by City contractors; and**
  - (c) issue written directives to clearly communicate relevant corporate policies and procedures to staff.**

#### **D.4. Lack of Adequate Control on Saturday and After-Hour Shipments of Fibre Products**

The contractor for processing recyclables at the Dufferin Material Recycling Facility also purchases recycled fibre materials from the City. Fibre materials are shipped out of this City facility, even on Saturdays and after normal City work hours when no City staff is on site. As a result, the City is exposed to certain potential liabilities if accidents happen on its property on weekends and after normal work hours.

In addition, the on-site weigh scale station is not staffed after normal work hours and weekends. Any outgoing shipments during these times are invoiced to the contractor based on weigh scale tickets issued by third parties at the destination mills. Staff currently investigates production and sales discrepancies in excess of 2 per cent. Discrepancies below 2 per cent currently amount to approximately \$34,000 annually. Given the relatively low level of the dollar value risk, it may be difficult to implement additional cost-effective controls to mitigate this risk.

#### **Recommendation:**

- 12. The General Manager, Solid Waste Management Services, review the Saturday and after-hour shipping arrangement in view of its benefits and risk exposure to the City.**

#### **CONCLUSION**

Effective contract management requires the support of strong protocols and procedures, enforceable contract terms and conditions, and adequate management oversight. While the four major contracts examined in our review are reasonably well managed, we noted opportunities for strengthened controls over monitoring of service quality, contract payments and compliance with contract terms and conditions.

Ensuring contractor compliance with the *Occupational Health and Safety Act* and controls over performance bonds and insurance certificates also require strengthening. Implementing the recommendations in this report will help enhance the overall efficiency of managing City contracts.

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