



STAFF REPORT INFORMATION ONLY

Policy Changes Required to Direct Fraud Recoveries to a Reserve

Date:	June 2, 2009
To:	Audit Committee
From:	City Manager
Wards:	All
Reference Number:	P:\2009\Internal Services\Cf\Ac09018Cf – et (AFS #9678)

SUMMARY

This report responds to a request from the Audit Committee to identify policy changes that would be required to allow recoveries made as a result of investigations by the Auditor General to be allocated to a general reserve fund, instead of being returned to the subject division where the losses occurred. Staff's position is that recovered funds should continue to be allocated to the accounts from which the funding was originally obtained or to the Non-Program account in cases where operating funds are recovered in future years. This is consistent with the conclusion of a prior report on this matter that was considered by Audit Committee in November, 2007.

Financial Impact

In cases where the City has lost funds through contract overpayments, fraud or other reasons and is successful in recovering some or all of those funds, the recovered moneys are currently allocated to operating or capital accounts, depending on the original source of the funds. Since this report does not recommend a change in City practise, there are no financial implications.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

The Audit Committee at its meeting of April 13, 2007 had before it Report AU 2.2 (March 8, 2007) from the Auditor General entitled ‘Annual Report on the Status of Fraud and Related Matters, Including Operation of the Fraud and Waste Hotline Program’. The Committee adopted the report and “requested the City Manager, in consultation with the Auditor General, to submit a report to the Audit Committee on the feasibility of allocating any funds recovered through the Auditor General’s investigations into a reserve account, accessible by the Auditor General for the investigation of further fraudulent activities.”

<http://www.toronto.ca/legdocs/mmis/2007/au/bgrd/backgroundfile-2634.pdf>

At its meeting of November 16, 2007, the Audit Committee had before it Report AU5.7 entitled ‘The Feasibility of Creating a Reserve Fund for the Recovery of Funds from the Activities of the Auditor General’s Office’ which was deferred until its meeting of February 22, 2008 as Report AU 6.6 at which time the report was received for information. The report concluded that no changes to existing practices were required, that any recoveries would continue to accrue to the accounts from which the funds originated, and, if any enhancements to the budget of the Auditor General’s Office were required, they would be considered as part of the annual budget process.

<http://www.toronto.ca/legdocs/mmis/2007/au/bgrd/backgroundfile-8233.pdf>
<http://www.toronto.ca/legdocs/mmis/2008/au/bgrd/backgroundfile-10650.pdf>

At its meeting of March 2, 2009, the Audit Committee had before it Report AU 10.2 (January 15, 2009) from the Auditor General entitled ‘2008 Annual Report – Fraud and Waste Hotline’. The Committee adopted the report and requested the City Manager to report to the Audit Committee on the “policy changes required in order to allow for recoveries made as a result of investigations by the Auditor General to be allocated to a general reserve fund, instead of being returned to the subject division where the losses occurred”. Council adopted the report at its meeting of April 29, and 30, 2009.

<http://www.toronto.ca/legdocs/mmis/2009/au/bgrd/backgroundfile-19077.pdf>

COMMENTS

1. Recoveries of Funds

On occasion, investigations by the Auditor General’s Office result in recovery of funds. In cases where such moneys are the property of the City, it should be noted that the funds were originally contained within the budget of a specific Program. There are three scenarios with respect to the nature of the recovery vis-à-vis those budgets:

- a. If the nature of the loss of funds impacts on a capital project, recovered funds would normally be returned to that capital project;

- b. If the nature of the loss of funds impacts the operating budget and the funds are recovered in the same budget year, they would be returned to the Program's operating accounts; and
- c. If the nature of the loss impacts the operating budget but the recovery is in a subsequent year, the recoveries would accrue to Non-program revenues in the year of the recovery.

In scenario (a), should the capital project be closed by the time that recovered funds have been received, then Accounting Services would return the funds to the capital project's original funding source(s).

In both of scenarios (b) and (c), the funds become a corporate resource and would be applied either in the year of receipt or the next year. In either case, transferring any recovered funds from operating accounts to a reserve fund would create an operating budget impact for Programs so affected.

2. Principles for the Use of Funds

Normally surplus operating budget funds revert to corporate surplus at year-end and are applied as a revenue source for the next year as prescribed by the *City of Toronto Act*. New revenues generally are applied to the operating budget with regard to the following principles:

- a. One time only funds should be used to fund one-off expenditures – one time only funds should not be used to fund on-going expenditure streams.
- b. Proceeds from fraud recoveries are an uncertain revenue stream since the quantum and timing of such recoveries cannot be known in advance. On the other hand, once an expenditure is budgeted for, it becomes certain. Certain expenditures should not be funded from uncertain sources.
- c. Reserves and reserve funds should be used to fund anticipated potential liabilities, stabilizing (smoothing of) revenues and expenditures that are subject to cyclical fluctuations, extraordinarily large purchases, or self-financing on-going activities.
- d. Financial risks should be recognized and properly funded with the appropriate budget.
- e. The spending of funds, the receipt of funds, the recording of the receipt and spending of funds, the appropriation of funds and the holding of funds for future use should conform to all municipal generally accepted accounting principles, and the policies and procedures of the City of Toronto Accounting Services and Financial Planning Divisions.

3. Rules for the Creation of Reserve and Reserve Funds

Should a decision be made to create a reserve or reserve fund from City funds however garnered, then the rules as set out by Council with regard to the establishment of such accounts holds. The rules for the creation, deletion and administration of City Reserve and Reserve Funds are set out in Municipal Code Chapter 227 – Reserve and Reserve Funds. In particular the Code specifies that a reserve, reserve fund or related account can only be established through a report to Council either authored by the Deputy City Manager/Chief Financial Officer or co-authored by same which must include:

- a. statement of purpose,
- b. designation of the owner or beneficiary program,
- c. rationale for the appropriate level to be maintained in the account or target (where appropriate),
- d. initial contribution, if any,
- e. contribution policy,
- f. withdrawal policy, and
- g. review cycle which would provide a periodic review to ensure a suitable level of funds, the appropriateness of the account, and the conditions, if any on which the account may be closed.

Normally, reserves and reserve funds would be created as part of the annual budget process, and each such account would be established through its own by-law. The by-law would set out the purpose of the reserve and any conditions on its application or funding as well as any special provisions not covered in the general policies of the City with respect to reserves and reserve funds.

The budget is the financial result of an operating plan and as such the need for an additional reserve and the funding of same is the logical result of the planning process which should be presented to the Executive Committee at the time of the overall budget.

4. Auditor General Recoveries as a Reserve Object

It is not clear for what purpose a general reserve which captured funds from audit investigations would be. As noted above, in order for funds recovered from investigations of the Auditor General's Office to be diverted to a reserve or reserve fund, a significant number of policies, practises and accounting principles would have to be violated or at least over-ridden as an exception.

CONTACT

N. Donald E. Altman, Manager, Corporate Financial Strategies
Phone: (416) 397-4220, Fax: (416) 397-4555; E-mail: daltman@toronto.ca

Len Brittain, Director, Corporate Finance
Phone: (416) 392-5380, Fax: (416) 397-4555; E-mail: lbrittai@toronto.ca

SIGNATURE

Joseph P. Pennachetti
City Manager