

Clause embodied in Report No. 7 of the Policy and Finance Committee, as adopted by the Council of the City of Toronto at its meeting held on May 21, 22 and 23, 2002.

1

**Proposal to Establish an Independent Auditor General
for the City of Toronto**

(City Council on May 21, 22 and 23, 2002, amended this Clause by:

- (1) *inserting the words “(excluding attest)” after the word “financial” in Recommendation No. (I)(2)(a) of the Policy and Finance Committee, so that such recommendation now reads as follows:*

“(2)(a) carrying out financial (excluding attest), compliance and performance (value-for-money) audits of all programs, activities and functions of the City and its Agencies, Boards, and Commissions;”;

- (2) *deleting Recommendation I(4) of the Policy and Finance Committee, and inserting in lieu thereof the following new Recommendation I(4):*

“(4) the current City By-law with respect to the appointment of the City Auditor be amended to reflect an Auditor General position; and any future changes or amendments to the By-law require a two-thirds majority vote to be enacted by Council;”; and

- (3) *amending Recommendation No. (I)(14) of the Policy and Finance Committee by:*

(a) *adding to the beginning thereof, the words “upon the expiry of the current City Auditor’s term of office or any renewal thereof”; and*

(b) *deleting from part (c) thereof the word “seven” and inserting in lieu thereof the word “five”, so that such recommendation now reads as follows:*

“(14) upon the expiry of the current City Auditor’s term of office or any renewal thereof, the Auditor General:

(a) *be selected through an impartial search process to identify candidates of the highest quality, possibly with the assistance of professional organizations such as the Institute of Chartered Accountants of Ontario;*

(b) *be appointed by Council on the recommendation of the Audit Committee; and*

(c) *be engaged under contract for a term of five years; and*

be remunerated within a range used for other senior officials of the City, but without performance bonuses or alternatively remuneration be set through an independent committee or firm engaged to recommend a level of remuneration;”.)

(City Council on April 16, 17 and 18, 2002, deferred consideration of this Clause to the next regular meeting of City Council scheduled to be held on May 21, 2002.)

(Clause No. 1 of Report No. 5 of the Policy and Finance Committee entitled, “Proposal to Establish an Independent Auditor General for the City of Toronto”)

(City Council on February 13, 14 and 15, 2002, deferred consideration of this Clause to the next regular meeting of City Council scheduled to be held on April 16, 2002; such Clause to be identified as a “time-sensitive” issue.)

(Clause No. 1 of Report No. 2 of the Policy and Finance Committee entitled, “Proposal to Establish an Independent Auditor General for the City of Toronto”)

The Policy and Finance Committee recommends:

- (I) the adoption of the following recommendations contained in the report prepared by Mr. Denis Desautels, entitled “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto”:**

“It is recommended that City Council establish the position of Auditor General of the City of Toronto with all the essential attributes of such a position and with the staffing and resources to form the office supporting the Auditor General. This position, its attributes and obligations and those of the Audit Office should be enshrined in the provincial statutes pertaining to the City of Toronto;

- (1) the position of City Auditor with its supporting staff be reorganized into two separate positions and units: an Auditor General reporting to Council and an Internal Auditor reporting to Management;**

Mandates and Reporting Structures:

- (2) the Auditor General’s mandate include:**

- (a) carrying out financial, compliance and performance (value-for-money) audits of all programmes, activities**

and functions of the City and its Agencies, Boards, and Commissions;

- (b) the powers already given to City Auditors under the Municipal Act of Ontario;**
 - (c) overseeing the work of the external auditors; and**
 - (d) following up implementation of any resulting recommendations;**
- (3) the Auditor General:**
- (a) report to Council through the Audit Committee and the Audit Committee recommend action to Council;**
 - (b) not report through the administrative structure;**
 - (c) prepare an annual report to Council by a prescribed date such as September 30, commenting on the trends observed, the state of control systems and on the “big picture”; and**
 - (d) report on the performance of his/her office on an annual basis;**
- (4) the Province be requested to change the City of Toronto Act to enshrine the Auditor General as a required position in the City along with its attributes, obligations, and supporting Audit Office;**
- (5) the Internal Auditor’s mandate include:**
- (a) providing management assurance that the systems for which they are responsible function properly;**
 - (b) investigating situations where management have concerns; and**
 - (c) reviewing the adequacy of controls in proposed new systems;**
- (6) the Internal Auditor:**
- (a) become part of the Chief Administrative Officer’s organization;**

- (b) keep the Audit Committee informed of its activities; and**
- (c) make all of its findings available to the Auditor General;**

Independence of the Auditor General:

- (7) the Auditor General have full authority to staff his/her office, to classify and promote staff, as well as engage contractors, within the City's overall rules and framework and staff should not be covered by the same collective agreements as other parts of the City;**
- (8) the budget of the Auditor General's Office be approved by Council but the Auditor General should be able to spend the authorized amount in the manner he/she deems most appropriate;**
- (9) the Auditor General be given latitude in accepting to carry out any special audits requested by individual Members of Council or Council itself and Council to adopt a clear set of operating rules, a convention or protocol governing such requests;**

Resources:

- (10) the Office of the Auditor General be established by using the appropriate resources from the current City Auditor to form the core on the new organization and recruit additional expertise to complement that of the current Audit Services group;**
- (11) the Internal Audit group be composed of 8 to 10 staff and possibly more temporarily to complete backlog;**
- (12) the budget:**
 - (a) for the Auditor General unit be \$2,150,000 to \$2,250,000;**
 - (b) for the external audit be transferred from the Finance Department to the Auditor General;**
 - (c) for the Internal Audit unit be \$900,000 to \$1,100,000; and**
 - (d) for the attest audit of smaller Agencies, Boards and Commissions be arranged differently;**

such costs representing an increase in total annual budget of \$500,000 to \$800,000;

Transition Measures:

- (13) the City develop special transition measures in the process of establishing a new audit regime;**

Selection:

- (14) the Auditor General:**

- (a) be selected through an impartial search process to identify candidates of the highest quality, possibly with the assistance of professional organizations such as the Institute of Chartered Accountants of Ontario;**
- (b) be appointed by Council on the recommendation of the Audit Committee; and**
- (c) be engaged under contract for a term of seven years; and**

be remunerated within a range used for other senior officials of the City, but without performance bonuses or alternatively remuneration be set through an independent committee or firm engaged to recommend a level of remuneration;

- (II) the adoption of the report (January 17, 2002) from the Chief Administrative Officer wherein it is recommended that:**

- “(1) if Council approves the recommendations in the AG Report “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto”, the City Chief Administrative Officer work with the City Auditor, in consultation with the City Solicitor and Commissioner of Corporate Services, to implement this strategy and report back to Council on any specific actions which may require Council approval; and**
- (2) the appropriate City Officials be authorized and directed to take the necessary action to give effect thereto.”;**

- (III) that the current City of Toronto Auditor (Mr. Jeff Griffiths) be appointed to the position of Auditor General for the City of Toronto;**

- (IV) that the work of the Internal Auditor commence immediately, reporting to the Chief Administrative Officer and the Auditor General;**
- (V) that the staff Implementation Team identified in Recommendation No. (1) embodied in the aforementioned report (January 17, 2002) from the Chief Administrative Officer, be augmented by including Councillors Sandra Bussin, Denzil Minnan-Wong, and Gloria Lindsay Luby; and be requested to work closely with the Audit Committee and submit a report in regard thereto to the Policy and Finance Committee for its meeting scheduled to be held on April 4, 2002, for submission to Council for its meeting scheduled to be held on April 16, 2002; and**
- (VI) that the Chief Administrative Officer be requested to submit a report to the Policy and Finance Committee:**
 - (a) on the need for a staff establishment control by-law in the City of Toronto;**
 - (b) on how a fiduciary code of ethics can be enacted and whether this would provide a better internal financial control and public accountability for the City of Toronto; and**
 - (c) exploring the feasibility of including the position of Auditor General into the City of Toronto Act as is the case in Winnipeg.**

The Policy and Finance Committee submits the following communication (January 17, 2002) from Mayor Mel Lastman addressed to the Chief Administrative Officer:

It is my privilege to present to you the Report of the Mayor's Task Force for the creation of an Independent Auditor General for the City of Toronto.

I have been advocating the creation of an Independent Auditor General since the last election because I believe our City needs to improve the accountability and transparency of its government. We need another set of eyes on the bottom line – and as such, I am endorsing the recommendations in “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto” and requesting that staff prepare a report for its implementation.

This report recommends the establishment of a truly independent Auditor General. An office, free from interference; an office that could save our city millions of dollars, and ultimately, an office that will improve the taxpayers' faith in their municipal government.

I would like to thank the Chair of the Task Force, Councillor Denzil Minnan-Wong and Task Force members Councillors Bas Balkissoon and Michael Prue. I would also like to express my appreciation to Mr. Denis Desautels, the former Auditor General of Canada. I would especially like to thank Mr. Tom Hards and the Institute of Chartered Accountants of Ontario. ICAO enthusiastically volunteered their assistance through a Steering Committee providing assistance and guidance to the Task Force.

Toronto is the fifth largest City in North America and has a budget larger than most provinces in Canada. Our budget for 2000 was over \$ 6.5 billion. Now more than ever our City must take measures to ensure that taxpayers' dollars are spent effectively and that the citizens of Toronto have confidence in the City's administration.

I look forward to hearing Council's views on this matter – and to the ultimate creation of the first Office of the Independent Auditor General for the City of Toronto.

The Policy and Finance Committee also submits the following communication (January 14, 2002) from Councillor Denzil Minnan-Wong addressed to Mayor Lastman:

I am pleased to present to you the final report of the Task Force for the Creation of an Auditor General for the City of Toronto. This report, entitled "Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto", is the culmination of extensive input from members of Council, City Staff and professional accountants.

As Council enters into a new budget cycle and the City is under more scrutiny than ever before, this report could not be more timely. Councillors, City Staff and the public are living in a new environment where we are all looking at ways of improving government through greater accountability and transparency, resulting in better and more open government. It is in this context that this report should be considered.

We have a tremendous opportunity before us in considering the creation of an Independent Auditor General and, as such, a chance to make an institutional change in city government. That is why a great deal of care was taken in putting together a team of individuals that reflected the importance of our challenge.

I am pleased to say that we were able to recruit Mr. Denis Desautels FCA, the former Auditor General for the Government of Canada. Mr. Desautels is the unquestionable expert in his field and the City was very fortunate to obtain his services. The City was also fortunate to have the support and assistance of the Institute of Chartered Accountants for Ontario (ICAO). The Institute formed a Steering Committee, whose membership included participants from all of the major accounting firms in the City of Toronto and provided important advice and guidance in the development of the Report. ICAO gave its time freely because they believe and are committed to assisting the City in improving its audit function. I would particularly like to thank Tom Hards, the Past President of ICAO and Mr. Dave Wilson for their efforts. Our team was rounded out with the other Task Force members, Councillors Bas Balkissoon and Michael Prue.

Throughout this process, all Councillors were given several opportunities to consult with and make recommendations to the Task Force. This input has been very helpful in the formulations of the attached report. What is more, Mr. Desautels met with many current and former senior City staff in the preparation of this report. This list of staff includes Shirley Hoy, Chief Administrative Officer, Jeff Griffiths, City Auditor, Rosanna Scotti, Director of Strategic and Corporate Policy, Bob Mavin, Director of Budget Services, Director of Development, Policy and Research, Finance and David Gunn. The report incorporates many of their thoughtful perspectives and experiences.

In addition, we received advice from the City of Montreal and the Provincial auditors of Ontario and Manitoba. The Task Force also contacted Michael Fenn, the Deputy Minister of Municipal Affairs for Ontario.

It is fair to say that while we cannot expect to get unanimity on all aspects of this report – there is general consensus that improvements are needed to improve the audit functions within the City of Toronto. Both Staff and elected officials believe these changes are a positive step to improving the City's audit function a model to follow for the future.

I believe that now, more than ever, this report represents the next step in the evolution of the City and I am proud to present it to you for your consideration.

(Report dated January 2002, prepared by Mr. Denis Desautels, OC, FCA
entitled, "Serving Council and Citizens: Strengthening the
Audit Function at the City of Toronto")

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Appendix A - ICAO Steering Group Members

Appendix B - Organizations Owned or Controlled by the City of Toronto

L. Denis Desautels, OC, FCA
4789 Massey Lane
Ottawa, Ontario

January 4, 2002

Councillor Denzil Minnan-Wong
Chair
Task Force on the Establishment of an
Independent Auditor General
City of Toronto

Dear Mr. Minnan-Wong,

The Mayor of the City has created a Task Force on the Establishment of an Independent Auditor General. The aim of the Task Force is to study the feasibility of creating the position of Auditor General for the City of Toronto. The ultimate goal is to help the Toronto City Council in its efforts to improve the way the City delivers services. As Chair of the Task Force, you have asked me to assist the Task Force by reviewing the current audit arrangements and developing a model which could be implemented to strengthen the current auditing regime at the City.

The recommendations contained in this report are aimed at giving the City of Toronto the best audit arrangements possible for such a large, complex and important city. They attempt to build upon the positive features of the current structures and, although they can be characterized as an evolution, they should be seen as a major step, a very significant step, in the development of accountability at the City of Toronto.

I am pleased to submit herewith my report to the Task Force.

Yours sincerely,

L.D. Desautels, OC, FCA

The Institute of Chartered Accountants of Ontario
69 Bloor Street East, Toronto, Ontario M4W 1B3

January 9, 2002

Mayor Mel Lastman
Toronto City Hall, 2nd Floor
100 Queen St. West
Toronto, ON M5H 2N2

Dear Mayor Lastman:

Thank you again for your invitation to the Institute of Chartered Accountants of Ontario to assist your Task Force to develop a model for the creation of an office of Auditor General of Toronto. As you know, our volunteer Steering Group consisted of chartered accountants who are senior partners of major firms. All are highly experienced in public sector auditing.

Working closely with Councillor Minnan-Wong, your Task Force's Chair, we first assisted in arranging for Denis Desautels, OC, FCA to conduct the detailed study necessary to evaluate the idea of creating an Office of the Auditor General of Toronto and proposing how it might be implemented. The Steering Group met several times with Councillor Minnan-Wong and Mr. Desautels to act as advisors and to provide constructive criticism and guidance in the development of his Report.

Mr. Desautels' Report reflects his considerable experience and credentials as the recently retired Auditor General of Canada and is worthy of Council's serious deliberation.

While the Report speaks for itself, our Steering Group stresses especially the importance of ensuring the independence necessary for this position. The creation of the Office of Auditor General, sufficiently independent and properly resourced, will help Toronto's Council and administration to use its resources with greater economy, efficiency and effectiveness, with benefits that will far outweigh the costs of establishing this new office.

We commend you for undertaking this challenge and look forward to providing any further assistance that we can.

Yours truly,

Thomas A. Hards, FCA - Chair
Steering Group on the Creation
Of an Office of the Auditor General for the City of Toronto.

Acknowledgments:

My work was greatly facilitated by the cooperation of many individuals who expressed their views quite freely, shared information and offered very helpful suggestions. These individuals included the Mayor, members of Council, certain members of City Administration and others outside the framework of the City of Toronto.

I am also grateful to the Steering Group of the Institute of Chartered Accountants of Ontario for their availability and sound counsel, on a voluntary basis, throughout this assignment. This Group was created to provide a sounding board for me and the Council Task Force. It was not asked to take a position on my recommendations to the Council Task Force.

(1) Executive Summary:

(1.1) What led to this review:

Discussions on the audit arrangements at the City of Toronto have been going on for some time. They began even prior to the January 1, 1998 amalgamation at which time the position of City Auditor was officially created. Over time, refinements have been made to the role of the City Auditor and to his relationship with both Council and City Administration. Nonetheless, the idea of establishing an "independent Auditor General" has been circulating since amalgamation and has been advocated by some members of Council. The motivating force is a firm desire to improve accountability arrangements at all levels throughout the City and to make Council more effective in its oversight role. A Council Task Force was formed by the Mayor to study the issue. I was asked to provide assistance to this Task Force and make recommendations on the establishment of an independent Auditor General.

(1.2) Process followed:

The process consisted of numerous interviews and discussions with people within and outside the City structures. The people within the City structures included both members of Council and members of City management. The people outside the City structures either had viewpoints to share on this subject or, because of their experience or backgrounds, had something valuable to contribute.

Documentation obtained from various sources was reviewed and taken into account.

(1.3) Current structure:

At present, the City of Toronto has in place the function of City Auditor. It is responsible to carry out audits of various aspects of the City's operations as well as audits of most of its agencies, boards and commissions. The City Auditor and the Audit Services group together comprise twenty-six (26) people and have an annual budget of approximately \$2.5 million. The City Auditor is appointed by Council and reports to Council. However, in keeping with accepted practice, these reports are first discussed with the Audit Committee of Council unless Council has asked to receive the reports directly.

The City Auditor also carries out work requested by the Administration and submits these reports to them. Because of increasing demands on the City Auditor by Council, the proportion of total time spent on work requested by City Administration has been declining.

In addition, the audit of the financial statements of the City and of its larger agencies, boards and commissions (such as the Toronto Transit Commission and the Toronto Hydro Corporation) is carried out by a firm of chartered accountants. The current external auditor was appointed for a five-year term starting January 1, 1998, following a public tendering process.

(1.4) Consensus around certain concepts:

Despite some positive features of the current arrangements, a number of changes need to be made in order to raise the current audit arrangements to a new level and to allow the audit function to play its role fully in strengthening overall accountability and focusing the attention of Council and of the Administration on the real issues the City is facing. Although this review was initiated by elected officials, members of the Administration also appear to be very supportive of this overall objective. Management recognize that they have some huge issues to address now and in the foreseeable future and that a well equipped and independent audit function could exert an influence on management to address these pressing challenges with focus and discipline.

The consensus which seems to be developing can be articulated around the following basic concepts:

- (i) there is a high level of respect for the City Auditor but, at the same time, there is strong support for an improved audit regime;
- (ii) there is support from both Council and the Administration for an independent Auditor General function to provide Council with solid value-for-money audits and with studies of broader, high level issues;
- (iii) the establishment of an Auditor General function should not be an end in itself, but should be seen as an important part of a concerted effort to strengthen governance structures and management and control systems;
- (iv) the Auditor General must not only enjoy real independence from management but must also enjoy institutional security and must be allowed to carry out his/her mandate with minimum interference; and
- (v) the establishment of an Auditor General function must take into account the external audit function as well as the needs of management for an internal audit and evaluation capability.

(1.5) Recommendations:

The recommendations in this report are aimed at strengthening the audit functions at the City of Toronto, thereby providing better support to Council and raising accountability at the City to a new level. The recommendations are also motivated by the desire to give the City of Toronto as modern and effective an audit regime as possible – one that is commensurate with and supportive of Toronto's status as a leading city in the world and the desire to maintain the very high quality of life its citizens enjoy.

Given its size, the complexity of its operations and the challenges it is facing, the City of Toronto would be well served by an Auditor General working exclusively for Council. My central recommendation is therefore as follows:

“Establish the position of Auditor General of the City of Toronto with all the essential attributes of such a position and with the staffing and resources to form the office supporting the Auditor General. This position, its attributes and obligations and those of the Audit Office should be enshrined in the provincial statutes pertaining to the City of Toronto.”

I feel that a properly constituted and independent Auditor General function, with the right leadership and a strong office to support the Auditor General, would go a long way in helping Council deal with the challenges the City of Toronto faces. Toronto is a big city, its total expenditures for 2000 were in excess of \$6.5 billion, which is more than the budget of most Canadian provinces. The need for an Auditor General and the potential benefits will continue to be significant in the years to come. While the work of an Auditor General can lead to greater efficiency and savings in city operations, it can also help improve the quality and effectiveness of services to citizens.

The recommendations in this report would lead to the elimination of the Audit Services group as it presently exists and would require some transition measures. The people currently employed in Audit Services could be transferred to the new Office of the Auditor General and to an Internal Audit group working for City management. The new structure would increase total costs by \$500,000 to \$800,000; the additional spending would be justified on the basis that there is a real expectation of benefits in excess of these costs. To maintain the focus on this objective, the Auditor General should report annually to Council on the performance of his/her Office.

(2) Introduction:

(2.1) The desire for change:

From what I was able to gather in the course of my work, discussions on the audit arrangements have been going on for some time. There were, quite naturally, discussions before the January 1, 1998 amalgamation leading to the recommendation made by the Transition Team to create “one internal audit department to provide services to the corporation” which would be headed by an officer known as the City Auditor. Since then, the mandate of the City Auditor as well as the relationships of that position with Council,

the Audit Committee of Council and City Administration have been gradually clarified. Nevertheless, there is still an on-going search for further refinements, which is not surprising in a new organization.

The idea of establishing an “independent Auditor General” has been circulating throughout this period and was indeed advocated by some members of Council. This was motivated by a desire to improve accountability arrangements at all levels throughout the new City and to make Council more effective in its oversight role. Having a truly independent Auditor General position, with all the right attributes and resources and with real influence, was seen as an essential element in achieving these objectives. An independent Auditor General would better be able to address areas and issues of greatest significance and keep Council and management focused on them. In addition, it would provide the citizens of Toronto with greater assurance of the efficiency and effectiveness of the City’s administration.

(2.2) Process set in motion:

In response to this desire, the Mayor formed a Task Force on the Establishment of an Independent Auditor General and asked Councillor Denzil Minnan-Wong to chair the Task Force. Other members of the Task Force were Councillors Bas Balkissoon (currently Chair of the Audit Committee) and Michael Prue (member of the Policy and Finance Committee). Councillor Prue was subsequently elected to the Ontario Legislature and could not complete his mandate as a member of the Task Force.

The Institute of Chartered Accountants of Ontario (ICAO) responded to a request to provide guidance to the Task Force on how an Auditor General function might best be established and on how to ensure the function is both independent and effective. A steering group of seasoned practitioners (Appendix A) was put together by ICAO and the group was chaired by Mr. Thomas A. Hards, FCA who was also Chair of ICAO. The Steering Group recommended to the Chair of the Council Task Force that he seek professional assistance in order to assess the current situation and develop a proposal which would be reviewed with the ICAO Steering Group and eventually brought to Council. I was asked to provide this assistance and reached an agreement to do so in August 2001.

(2.3) Objectives of this study:

The objectives of this study were essentially to analyze and assess the current arrangements for internal and external auditing at the City and to propose to the Council Task Force a structure for carrying out these functions in the future. It was understood that there were elements of the current system which seemed to function satisfactorily as well as a number of dedicated staff who wanted to contribute to the betterment of City operations and that the study should take these into account.

In addition to the above, I was particularly motivated by the vision of giving the City of Toronto as modern and an effective audit regime as is feasible – one that is

commensurate with and supportive of Toronto's status as a leading city in the world and the desire to maintain its very high quality of life.

(3) Process followed:

In order to properly understand the current situation at the City of Toronto and to be able to formulate what I hoped would be sound observations and recommendations, I carried out a number of interviews, obtained and studied documentation from various sources within the City, consulted different people who might be able to share useful knowledge and analyzed all the information thereby obtained using my experience as Auditor General of Canada and my knowledge of other jurisdictions in Canada.

In addition to the Mayor, meetings and interviews were held with fifteen (15) members of Council. Meetings with representatives of the Administration included meetings with the acting Chief Administrative Officer, the City Auditor and the Corporate Services Commissioner. I had discussions with representatives of the City's external auditors, Ernst & Young LLP, and met with the ICAO Steering Group on a number of occasions. Discussions with people outside the City structure included discussions with the Deputy Minister of Municipal Affairs and Housing, the Provincial Auditor of Ontario and City Auditors of other cities in Canada.

(4) Assessment of the Current Situation:

(4.1) Current arrangements:

Without necessarily getting into all the details, it is important to understand the range, size and complexity of the City of Toronto's operations and how the various audit activities across the City structure are carried out.

The audited financial statements of the City list the numerous (approximately 70) agencies, boards and commissions that are owned or controlled by the City and are accountable for the administration of their financial affairs and resources to City Council (Appendix B). While some, such as community centres and business improvement areas, are relatively small, others like the Toronto Transit Commission and Toronto Waterworks Utility are very large. In general, these organizations are given much autonomy under the City's decentralized approach, which tends to increase the need for the kind of assurances which auditors can provide to Council.

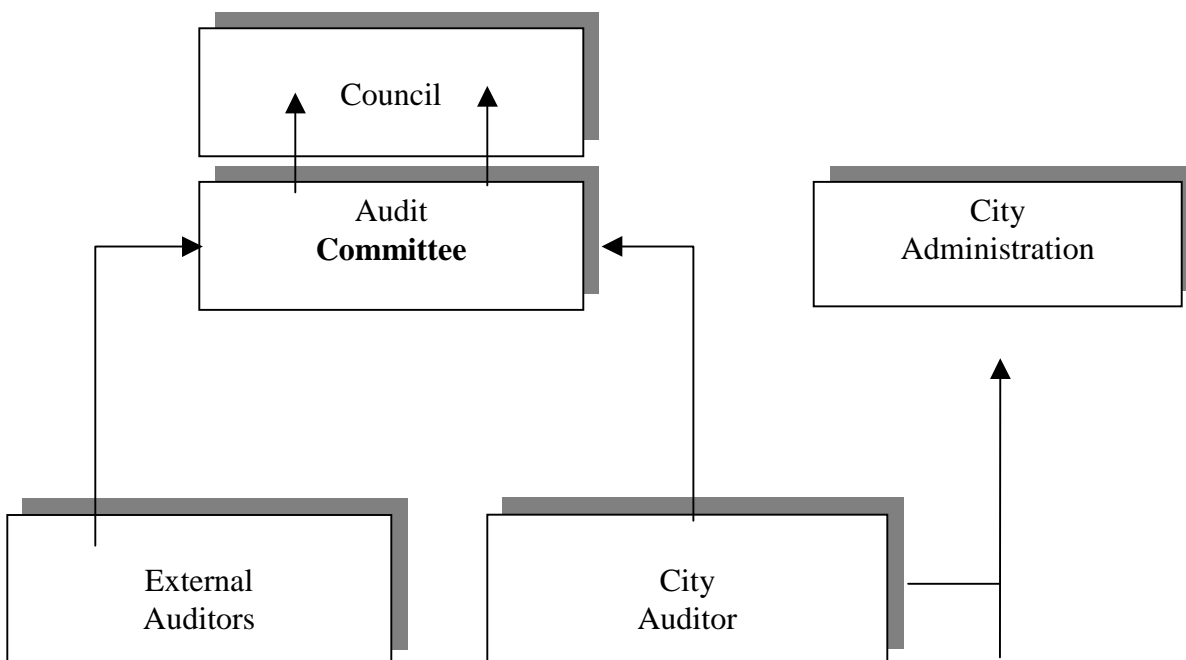
According to the consolidated financial statements for the year 2000, total expenditures amounted to more than \$6.5 billion. This total excludes the activities of what are called "business enterprises" (Toronto Hydro, Enwave District Energy Limited, Toronto Parking Authority and Toronto Economic Development Corporation), whose expenditures for the year 2000 were in excess of \$2 billion. By any measure, the City of Toronto is a large and complex organization and members of Council need to be served by a very strong and effective audit regime.

For purposes of this report, we can divide the audit activities into two components, i.e., internal and external auditing as illustrated in Exhibit 1. This leaves out what one might call “programme auditing”, i.e., auditing/monitoring of programme delivery or service quality elements by programme managers to ensure on an ongoing basis that their programmes are functioning properly. This is often done for programmes paying out benefits where there are concerns about eligibility, speed of processing applications for benefits as well as risks of over/under payments.

The external auditing mandate is given to a firm of Chartered Accountants (presently Ernst & Young LLP) for a five-year term following the public tendering process. That process is managed by Finance Staff. The contract, once approved by Council, is awarded by the Chief Financial Officer and Treasurer and funded by Finance’s budget. The nature of this assignment consists of providing an opinion on the consolidated financial statements of the Corporation of the City of Toronto and separate opinions on the financial statements of over thirty (30) agencies, boards, and commissions (ABC’s) such as the Toronto Transit Commission and the Toronto Hydro Corporation, and trust funds. In addition to their opinion on the financial statements, the external auditors provide an annual report on the result of their audit to the Audit Committee and more detailed recommendations to management. The annual fees for the services of the external auditors are approximately \$1 million.

Exhibit I

City of Toronto
Overview of Current Auditing Structure
(December 2001)



Attestation of financial statements for:
City; Certain agencies, boards and
commissions such as:

- (1) Board of Governors of
Exhibition Place
- (2) Toronto Economic
Development Corporation
- (3) Toronto Housing Company
Limited
- (4) Toronto Hydro
- (5) Toronto Transit Commission
(TTC)
- (6) Toronto Zoo

Internal auditing, i.e. operational audits, audits of
compliance and of integrity of systems of internal
control, forensic audits and special investigations
carried out for Council and assignments requested
by management for the City and its boards and
enterprises (except those entities such as TTC and
Toronto Housing Company which have their own
internal audit services)

Attestation of financial statements of
approximately 80 entities such as arenas,
community centres and business improvement
areas

The City Auditor is appointed by Council for a five-year term and he reports to Council through the Audit Committee of Council, i.e., his reports are addressed to Council but they are first discussed with the Audit Committee.

The mandate of the City Auditor has been developed through discussions between the City Auditor and the Audit Committee of Council and has been reaffirmed and clarified through the annual review of the operating plans and budget of the Audit Services group. The group's mandate and work methods have been articulated around the concepts of internal auditing and the City Auditor and his staff indeed follow the standards of the Institute of Internal Auditors. This is the case in many municipalities as City Auditors have identified more as internal auditors. In the case of Toronto, the mandate has been evolving as the City Auditor works more and more for Council - reporting more to Council and proportionately less to City Administration.

As Exhibit 1 illustrates, the City Auditor has a considerable range of responsibilities given the size and scope of the City's operations and the number of ABC's. The City Auditor plays a limited role in the external audit of the City's financial statements or of the ABC's audited by the external auditors. There is a sharing of information between the two groups and the Audit Services group supplies some staff support to the latter (approximately 1000 hours). The City Auditor prepares an annual work plan which is reviewed with the Audit Committee and approved by Council, as is the annual net budget which amounts to approximately \$2.5 million. That budget covers mostly staff costs (26 full-time equivalents) and related costs and does not really provide funds for retaining consultants or other experts on contract. Over and above his annual work plan, the City Auditor must also accommodate numerous requests from Council for additional audits.

As noted above, the City Auditor carries out a number of audits and consulting assignments at the request of City Administration. The reports produced as a result of that work are given to management but the Chair of the Audit Committee is advised of this work and given a copy of the reports on request. The balancing of this dual role by the City Auditor is not easy as other City Auditors would attest. In the case of the City of Toronto, the dual role has created frustration on the part of both members of Council and the Administration.

(4.2) Positive features:

One of the more positive features that seems to come out of interviews with both Councillors and members of the Administration is a high level of respect for the current City Auditor, despite the inevitable frictions that a legislative auditor working in a political environment has to go through. This is all the more remarkable in that the City Auditor is seen as being pulled in different directions by having to meet the needs of both Council and the Administration, as just previously described.

The other positive feature that came through was the relative efficiency of the Audit Service group and the relatively short time frame within which it produced the requested reports. While the volume of requests from Council is a real concern and drives the City Auditor away from his own work plans, he is seen as being very responsive to Council, in terms of both substance and timeliness.

There also seems to be good interaction between members of Council and the City Auditor and members of Council have shown a high degree of interest for the reports produced by the City Auditor.

These are very positive features that must be preserved.

(4.3) What needs to change:

Despite the positive features just described, a number of changes need to be made to raise the current audit arrangements to a new level and to allow the audit function to play its role fully in strengthening overall accountability and focusing the attention of Council and of the Administration on the real issues the City is still facing following the January 1, 1998 amalgamation.

The main issues that have come out of interviews can be summarized as follows:

- (i) there is a desire for a completely independent audit function. The City Auditor should be organizationally independent and work exclusively for Council and Council should let the City Auditor carry out his work plans with relatively few requests for special investigations;
- (ii) there is also a desire for the City Auditor to tackle higher-level questions, real value-for-money issues, as well as programme results and performance questions. There is a valid expectation that tackling more such issues would make Council more effective. A practice, well understood by all, of following up implementation of recommendations would also have an impact on correcting shortcomings;
- (iii) there is also a desire for more effective accountability across the whole organization and a strong audit function is seen as an important influence in bringing this about;

- (iv) the City Auditor should also have more of a role to play in the performance of the external audit. While there is a certain coordination of the two exercises, it is essential that the City Auditor be able to benefit to a greater extent than now exists from the knowledge of City operations gained in carrying out the external audit work. This could also bring about greater benefits to the City from the external audit; and
 - (v) the audit of the financial statements of a number of smaller boards such as community centres and local improvements areas are a drain on the resources of the City Auditor and alternatives must be explored, i.e., are they all necessary? Could they be contracted out?
- (5) Emerging Consensus around Basic Concepts:

As I progressed through this assignment and discussed these questions with members of Council and with City management, it became apparent that there was a general desire for changes to strengthen the audit arrangements. Indeed, although this exercise was initiated by elected officials, I was impressed by the extent to which members of the Administration are also supportive of these objectives. Management seem to recognize that they have some huge issues to address (financial systems, financial reporting, budgetary control, general strengthening of management processes and skills) and that a well equipped and independent audit function can exert an influence on management to address these pressing challenges with focus and discipline.

Of course, even when people agree on the need for change, it is always more difficult to agree on the actual solutions. However, I feel it is encouraging that there is support in all quarters for strengthening the audit arrangements.

The emerging consensus can be articulated around the following basic concepts:

- (i) there is a high level of respect for the City Auditor but, at the same time, there is strong support for improving all aspects of the audit regime;
- (ii) there is support within both Council and the Administration for an independent Auditor General function to support Council with solid value-for-money audits and with examinations of broader, high level issues;
- (iii) the establishment of the Auditor General function should not be an end in itself, but should be seen as an important part of an effort to strengthen governance structures and management and control systems;
- (iv) the Auditor General must enjoy not only real independence from management but must also enjoy institutional security and must be allowed to carry out his/her mandate with minimum interference; and

- (v) the establishment of an Auditor General function must take into account the external audit function and the needs of management for an internal audit and evaluation capability.

(6) Some Difficult Questions:

While there may be a fairly good consensus around certain concepts, there are a certain number of difficult questions that are being asked by various observers, that must be answered in order to agree on the ultimate model to be adopted.

- (1) Can an Auditor General really function with a government structure where there are no parties and there is no executive?

The concern expressed by many is that Auditors General function very well at the federal and provincial levels where elected officials belong to a number of parties, where Ministers are responsible for their department and where the Government is held collectively responsible through the Cabinet structure. By comparison, Toronto City Council is made up of the Mayor and forty-four (44) Councillors who are not grouped into party structures and although there are a number of committees of Council, no Councillor is responsible for the administration of individual services and programmes in the same way a Minister would be. There is also no executive committee as there is in some municipalities such as Montreal. This makes for quite different dynamics than one would find at the federal or provincial level.

Nevertheless, in my view, a strong audit function to support Council is just as needed, if not more so, in this kind of environment than in the more structured federal or provincial environments. Individual Councillors do not have the resources of a political party with its own researchers to draw upon and must be able to count upon the work of an independent auditor in order to fulfill their own oversight duties. One can also argue that real accountability is harder to achieve in this kind of environment, hence the greater need for the kind of information or assurances that an independent auditor can provide.

- (2) Is it possible to limit in any way the ability or privilege of Council to request that the Auditor General/City Auditor perform specific audits?

The question here is not whether Council can request that the Auditor General/City Auditor carry out certain audits or enquiries. The answer to that is, of course, "yes". However, virtually all people, including the majority of members of Council interviewed, agree that the number of such requests should be controlled so that the auditor is not prevented from carrying out the work he/she feels is a priority or is likely to give the greatest payback.

The other danger is that the auditor can be drawn into individual Councillors' agenda and that the auditor's impartiality or neutrality could then be put in question.

In my view, means have to be found such as a Council protocol, or a more formal policy, which would reduce the number of such requests to the point where they become much more of an exception than has been the case so far. Such protocol or policy should emphasize the fundamental objective or principle pursued and set some rules, such as the level of consensus required and the flexibility given to the Auditor General/City Auditor, to achieve that objective.

- (3) What should the role of the Auditor General /City Auditor be in the audit of the financial statements of the City and its agencies, boards, and commissions?

As described earlier, the City Auditor plays a relatively minor role in the audit of the financial statements of the City and some of its large ABC's. This role consists of advice in the selection of the firm to carry out the external audit, some exchange of information to permit reliance by the External Auditors on the work of the City Auditor and staff support in the execution of the audit (approximately 1,000 hours/year). While it is currently the practice at the municipal level in Canada to have both an internal and an external audit function, it seems essential that there be really effective coordination of the two efforts.

At the federal and provincial levels, Auditors General carry out the external audit and attest to the fairness of the Government's financial statements. This provides them with a very useful window from which to oversee the financial operations of government and plan their value-for-money and compliance work.

I am of the opinion that if the City of Toronto wishes to strengthen the role of the City Auditor, it should consider seriously giving him a significantly greater role in the external audit process.

- (4) Is Council ready to pay more for a strengthened audit regime if there are reasonable prospects of benefits?

Given the current financial situation of the City and the very tight control over spending requests, any proposal to spend more on a service is likely to meet resistance. There is little doubt that strengthening the audit regime would cost more. However, any additional spending would be based on the premise that it would produce benefits or savings in excess of the incremental spending.

It should be noted that the current level of spending by the Audit Services group appears quite reasonable when compared to other cities in Canada and in the United States. Benchmark data submitted as part of their 2002 Operating Plan and Budget shows that Toronto would be in a cluster representing the bottom 40% of the cities used in the comparison.

The benefits (better information to Council, greater accountability, improved services to citizens, better management systems) and the savings that stem from an effective auditing structure with the right resources are usually quite demonstrable even if they cannot always be quantified. However, an increase in

spending for audit services should be accompanied by an effort to report on the performance of the audit organization.

(5) How important is the title of the function?

A few people have expressed the view that the auditing function would be strengthened but that the title “City Auditor” should be retained. They argue that this is the prevalent practice in the municipal world, that the term is well recognized and that it distinguishes municipalities from the federal and provincial levels of governments.

It may seem that to some this should not be such an important issue – but it is. One can argue that using the term “Auditor General”, which has become a familiar title in Canada at both the federal and provincial levels, could send a strong message. It could signal to its citizens that the City is very serious about strengthening the audit function and that it wishes to distinguish itself among North American cities in this respect. It would also ensure that the function is really seen as an independent one and that it is not to be confused with one that is primarily an internal audit function working for the Administration, as is the case in a number of municipalities.

(7) Recommendations for Strengthening the Audit Regime:

(7.1) The central recommendation: an Auditor General working for Council:

I am convinced that given its size, the scope and complexity of its operations and the challenges it is facing, the City of Toronto would be well served by an Auditor General working exclusively for Council. My central recommendation is therefore as follows:

“Establish the position of Auditor General of the City of Toronto with all of the essential attributes of such a position and with the staffing and resources to form the office supporting the Auditor General. This position, its attributes and obligations and those of the Audit Office should be enshrined in the provincial statutes pertaining to the City of Toronto.”

I feel that a properly constituted Auditor General function with the right leadership and a strong office would go a long way in helping Council deal with the challenges the City of Toronto faces. It would also exert a positive influence on City Administration to deal with the organizational, systems and operational problems that are already known as well as those that will crop up in the future. Toronto is a big city – its total expenditures for the year ended December 31, 2000 were in excess of \$6.5 billion, which is more than most of Canada’s provinces. The need for an Auditor General function and the potential benefits are likely to continue to be significant in the years to come.

The office supporting the Auditor General must be regarded by all stakeholders as a highly professional organization, being helpful to those departments, agencies, boards and commissions whose operations it examines. These positive relationships should not

impair the independence of the Auditor General or limit his/her reporting responsibilities to Council.

It would be very important to enshrine the Auditor General function in the provincial statutes that pertain to the City, i.e., the City of Toronto Act, instead of doing it through a by-law. Although this act can only be changed through the provincial legislature, it is crucial to do so in order to ensure that the function is not changed so easily as to diminish its importance, its independence and its continuity. This is the case in some cities, such as Winnipeg where the City of Winnipeg Act deals with the functions and powers of the City Auditor.

There is indeed a useful example provided by the Board of Health for the City of Toronto Health Unit and the appointment of a medical officer of health for that unit; these functions are described in both *the Health Protection and Promotion Act* (which applies to all health units) and *the City of Toronto Act*.

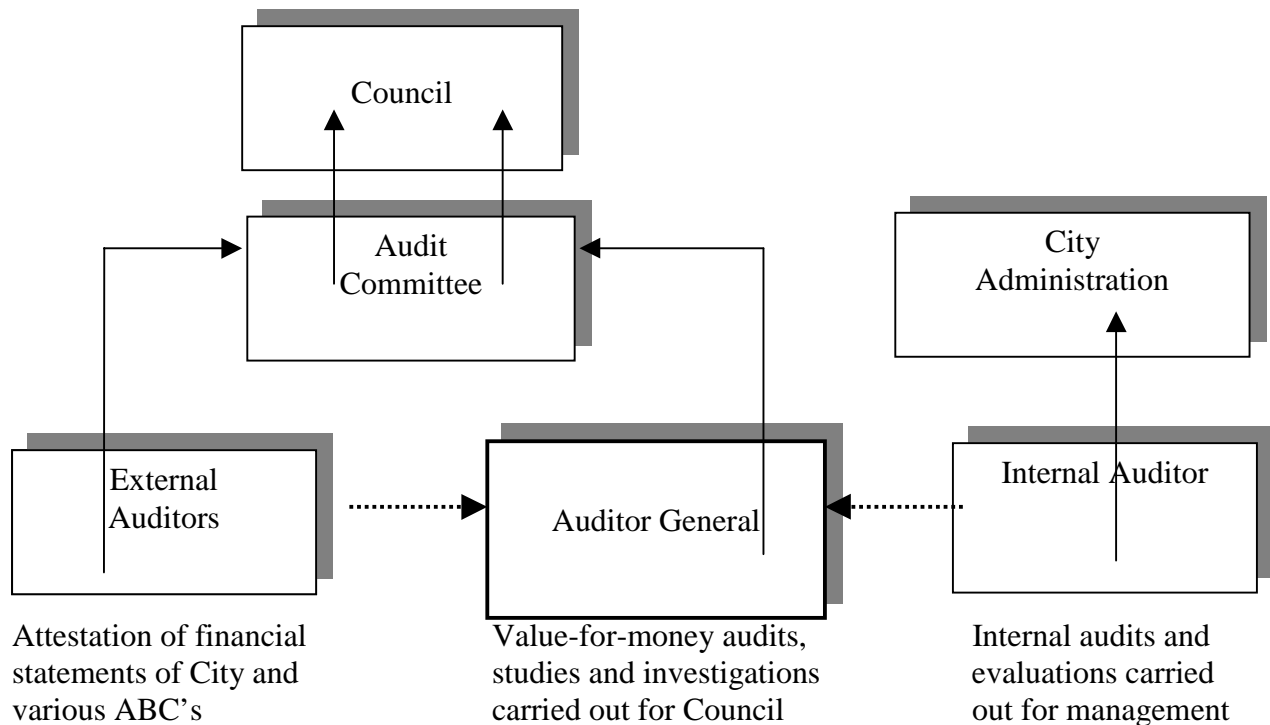
The personal independence of the Auditor General must also be ensured and Council must be certain that the Auditor General is not vulnerable to pressures that would hamper him/her in carrying out the examinations necessary to the discharge of his/her responsibilities.

As explained later in this section, the staff of this new Office could come mostly from the present Audit Services group which supports the City Auditor. Other members of Audit Services could form the core of a purely internal audit and evaluation function, which is also explained later. As the proposed structure shows (see Exhibit II), the position of City Auditor would cease to exist and would be replaced by an Auditor General reporting to Council and an Internal Auditor reporting to management.

It should also be noted that the Auditor General, in addition to the powers that would be given to him/her by the City, would carry the powers already given to City Auditors under *the Municipal Act of Ontario*.

Exhibit II

City of Toronto Overview of Proposed Auditing Structures



Note 1: The Auditor General and the External Auditors are appointed by Council and report to Council through the Audit Committee.

Note 2: External Auditors would work “under the direction” of the Auditor General, as is done by auditors of Crown Corporations with the Provincial Auditor.

Note 3: The Internal Auditor would work for the Administration and submit his reports to them. The Audit Committee should be kept regularly informed of the activities of the Internal Audit group.

(7.2) Implementing the concept:

The following summarizes how the concept of an Auditor General might be implemented at the City of Toronto, taking into account its current governance structures and practices as well as those features of the current system which appear to be working well.

(a) Mandate and powers:

The Auditor General should have the responsibility to carry out financial, compliance and performance (value for money) audits of all programmes, activities and functions of the City and to report his/her findings directly to Council through its Audit Committee. The Auditor General must be given all the powers necessary to carry out those responsibilities.

The Auditor General should also have the authority to carry out or cause to be carried out the above types of audits in the City and in all of its agencies, boards and commissions.

(b) Resources:

The Office of the Auditor General should be established by using the appropriate resources from the current City Auditor to form the core of the new organization. This would have the advantage of building upon some of the existing expertise and ensuring a smooth transition.

The new Office of the Auditor General would need to recruit additional expertise (value-for-money auditors, experts in effectiveness or in different functional areas) to complement that of the current Audit Services group.

The budget of the new Office could be somewhat less than the current \$2.5 million annual budget of the City Auditor. This is based on the assumption that a corporate internal audit capacity would be maintained to carry out work presently carried out at the request of management (see later comments on internal audit) and that different arrangements would be made for the attest audits of smaller agencies, boards and commissions.

However, taken together, the operating costs of the Office of the Auditor General and of a new internal audit and evaluation group are likely to be from \$500,000.00 to \$800,000.00 more than the current costs of the City Auditor. As indicated earlier, the total spending on these auditing functions would not be out of line with that of other cities as Toronto is presently among those cities spending relatively less.

The cost of the new structure could be summarized as follows:

Audit Services Budget for 2001	\$ 2,550,000.00
Additional costs	\$ 500,000.00 - \$ 800,000.00
Suggested New budget	\$ 3,050,000.00 - \$3,350,000.00
Suggested breakdown:	
Auditor General	\$ 2,150,000.00 - \$2,250,000.00
Internal Audit	\$ 900,000.00 - \$1,100,000.00

(c) Appointment and tenure:

The Auditor General would be appointed by Council on the recommendation of the Audit Committee for a seven-year term.

It is important to make the term long enough in order to attract good candidates who may be reluctant to leave their current employment for a shorter engagement than the recommended seven years. A term of seven years also gives the office

holder enough time to formulate a vision or agenda for the Office and be able to implement it.

Council and the Audit Committee should seek the help of professional organizations such as the Institute of Chartered Accountants of Ontario when searching for candidates for the position of Auditor General. It would be important to put in place a process that would be totally impartial and that would identify candidates of the highest quality.

The remuneration must be both fair and attractive to potential candidates. It should therefore be within the remuneration ranges used for other senior officials of the City. However, it would not be appropriate to introduce performance bonuses as this could hamper independence. Alternatively, an independent committee or a firm could be asked to recommend a level of remuneration.

(d) Internal audit and evaluation group:

With the establishment of an Auditor General function, management would still need their own internal audit and evaluation capability to serve their needs and enable them to meet their responsibilities for maintaining proper systems of internal control.

Management in larger organizations need some form of capability to provide them assurance that the systems for which they are responsible function properly, to investigate situations where they have concerns and to review the adequacy of controls in proposed new systems. This is legitimate and the City of Toronto is big and complex enough to need both an independent Auditor General function and an internal audit group. I estimate that a group of eight to ten people would be adequate, although it could be argued that a somewhat larger group could be needed initially because of the backlog of work that senior management is facing. Such a group should be part of the Chief Administrative Officer's organization.

It is important to understand that this internal audit work should not be carried out by the Auditor General. The two roles are quite distinct. If the Auditor General were asked to carry out the internal audit work, it would take the City right back to a situation similar to the current one. The Auditor General would be again in an awkward position of serving two masters, it would diminish the degree of his/her independence from management and senior management would not be served as they ought to be.

The work of this group and its reports would be available to the Auditor General who would take them into account when planning and carrying out his/her own audits. There will have to be good communications and relations between the two groups to ensure there is no duplication of effort, that the scheduling of audits is timely and that the City derives the maximum benefits from all audit activities.

There could also be, as there are now, “programme auditors” as management see fit to monitor the integrity of programme delivery or service quality, but this activity would be under the responsibility of programme managers and funded from their own budgets.

(e) External audit:

At the federal and provincial levels, the audit of the government’s financial statements is carried out by the Auditor General. This has not generally been the case at the municipal level for a number of historical and legal reasons. However, if a large city like Toronto has in place a truly independent and properly resourced Auditor General function, the audit of the City’s financial statements could be carried out by the Auditor General. This would give the Auditor General a window on the operations of the City which is very useful in maintaining a level of knowledge of all city operations from which to plan and carry out value-for-money audits or special investigations.

This would be a major step which Council may not wish to take at this time. It could indeed be considered later as the new Office of the Auditor General builds its strength and reputation and when Council is satisfied that the Office of the Auditor General has fully met its expectations in regards to the value-for-money audit work that it expects.

For the time being, the external audit of the City’s financial statements and those of its larger agencies, boards and commissions should continue to be carried out by a public accounting firm but it could be done under contract with the Auditor General, with funds being transferred from Finance for that purpose.

As a minimum, the external audit of the City’s financial statements and those of its larger agencies, boards and commissions should be carried out as currently but with the external auditors working “under the direction” of the Auditor General as is done for certain large entities of the Ontario government (e.g. Workplace Safety and Insurance Board) with the Provincial Auditor. Under those arrangements, the reports of the entities’ auditors are addressed to the Provincial Auditor in addition to the Boards of Directors and the Minister. The Provincial Auditor is consulted on the appointment of the external auditors and he has access to management letters, audit reports and any additional information which he may need in the discharge of his own duties.

(f) Reporting structures:

The reporting relationships of the new Auditor General function would be essentially the same as they are now for the City Auditor, i.e. the Auditor General would report to Council through the Audit Committee. This would apply to individual audit reports as well as to budgets and outlining annual workplans.

Council should adopt a clear set of operating rules or a convention governing requests for special audits by individual members of Council or by Council itself. The Auditor General should be given latitude in accepting to carry out such audits and his regular duties must take precedence over special requests (see *S.17 of the Audit Act of Ontario*).

The ultimate objective is that audits carried out directly as a result of requests from Council should become much fewer and even relatively rare, as is the case at the federal and provincial levels and even in many municipalities. However, the Auditor General should take seriously into account concerns or requests expressed by members of Council when preparing his/her annual workplans.

The Audit Committee, after discussing individual reports of the Auditor General, should indicate to Council its agreement (or reservations) with the conclusions of the Auditor General and encourage the implementation of the recommendations contained therein.

In addition to individual reports, the Auditor General should prepare an annual report to Council commenting on the trends observed, the state of control systems and on the “big picture”. He/she could also include reports or extracts of reports produced by any external auditor retained by the City deemed important to bring to Council’s attention. Such a report should be tabled before a prescribed date - September 30 would be an appropriate time for reporting on the activities of the year ended on the previous December 31.

(g) Staffing and contracting:

It is essential, in order to discharge his/her responsibilities, that the Auditor General have full authority to staff his/her office, to classify and promote staff, as well as engage contractors, within the city’s overall rules and framework.

Persons employed in the Office of the Auditor General should not be covered by the same collective agreements as employees in other offices of the City to ensure real independence.

(h) Budget:

The budget of the Auditor General should be approved by Council but the Auditor General should be able to spend the authorized amount in the manner he/she deems most appropriate, e.g., as between using full-time staff or outside contractors. This is the case now with the City Auditor.

(i) Performance Reporting:

The Auditor General should report on the performance of his/her Office on an annual basis. This is a growing practice among legislative auditors and it is

consistent with the concept that all public sector organizations should provide regular, credible and balanced reports on their performance.

(7.3) Transition measures:

The recommendations made in this report are intended to serve the City well into the future. However, they involve some reorganization of existing functions and consequently would have an impact on a certain number of people, some of whom have formal employment contracts. It goes without saying that in implementing these recommendations and setting up a new regime, the City will have to take that into account and may need to consider special transition measures. This report has not laid out what these might be since such policy issues are a prerogative of Council.

(7.4) Summarizing the proposed changes:

The recommendations contained in this report are aimed at giving the City of Toronto the best audit arrangements possible for such a large, complex and important city. They attempt to build upon some of the positive features of the current structures and although they can be characterized as an evolution, they should also be seen as a major step, a very significant step, in the development of accountability at the City of Toronto.

The changes that are proposed could be summarized in the following manner:

- (1) A more independent audit function:
 - (i) An Auditor General working exclusively for Council;
 - (ii) More freedom to set his/her agenda;
 - (iii) A role enshrined in the City statutes; and
 - (iv) The incumbent is given adequate security.
- (2) An audit function which is able to focus on higher level issues and on value-for-money audits:
 - (i) The Auditor General's mandate would set out Council's expectations;
 - (ii) An office with better resources and good training;
 - (iii) An office which can better influence Management and Council to focus on the most important issues; and
 - (iv) An office which can make Council more effective in its oversight role.

- (3) An Auditor General function would be better able to raise the level of accountability across the organization:
 - (i) The Auditor General could use his/her influence and powers to encourage better accountability both within the management structures and from management to Council and citizens.
- (4) An Auditor General function with the right resources could have a greater influence on the efficiency and effectiveness of City programmes and the quality of services to citizens:
 - (i) The benefits from a well functioning audit function can easily outweigh the costs, particularly in a large and complex organization.
- (5) The Auditor General would play a greater role in the external audit of the City and its agencies, boards and commissions:
 - (i) The greater knowledge of City operations thereby gained would help the Auditor General in planning his/her own value-for-money audits and investigations; and
 - (ii) The increased synergy could also have an impact on the effectiveness of the external audit.
- (6) A distinct internal audit group to serve management's needs:
 - (i) Management would be better equipped to meet their responsibilities for proper systems of information, financial management and internal control.

Conclusions:

The new City of Toronto is now almost four years old. Amalgamation represented a huge challenge and in many respects it still does.

The new City not only had to go through all the difficult phases of amalgamation, it also had to deal with a realignment of its responsibilities with those of the Province of Ontario. Needless to say, this was at times painful, and it was hard on people whether they be staff or elected officials. Indeed, some of the problems are not yet fully resolved.

The proposal for an independent Auditor General which was brought forward by some members of Council comes at a critical time. It would not be realistic to think that an Auditor General could solve all of the problems facing the City. But the creation of an independent Auditor General function could be part of an overall effort aimed at strengthening governance structures and management and control systems.

Indeed, the Auditor General could be of great assistance to Council by bringing forward high quality value-for-money reports and studies of the broader and very fundamental issues that the

City has to resolve. The Auditor General could also exert influence on management to improve their practices and to keep their focus on the important issues they have to address.

There seems to be a good level of consensus on the need to strengthen the audit regime and on the potential benefits of an independent Auditor General function. I am convinced that this would be of benefit to all stakeholders – members of Council, members of City Administration, ratepayers and all those who count on the city's services and support. Toronto is a most important city – it needs to give itself the best governance structures possible.

Denis Desautels, OC, FCA
January 2002

Appendix A

Institute of Chartered Accountants of Ontario (ICAO) Steering Group Members

Chair

Thomas A. Hards, FCA
2000-2001 Chair of ICAO
Hards Pearson, Barrie

Members

Robert Correll, CA
KPMG LLP, Toronto

Steve Spiers, CA
BDO Dunwoody LLP, Toronto

Neil M. Brown, CA
Arthur Andersen LLP, Toronto

Alan Gunn, FCA
Deloitte & Touche LLP, Toronto

Frank Kelly, FCA
Grant Thornton, LLP, Toronto

Advisor

David A. Wilson, FCA
President & CEO of ICAO, 1978-2001

Appendix B

Organizations Owned or Controlled by the City of Toronto (per Note 1 to the consolidated financial statements)

Consolidated entities -

- Board of Directors of the Hummingbird Centre for the Performing Arts
- Board of Governors of Exhibition Place
- Board of Management of the Toronto Zoo
- St. Lawrence Centre for the Arts
- The North York Performing Arts Centre Corporation
- Toronto Atmospheric Fund
- Toronto Board of Health
- Toronto Historical Board
- Toronto Housing Corporation
- Toronto Licensing Commission
- Toronto Police Services Board
- Toronto Public Library Board
- Toronto Transit Commission
- Toronto Waterworks Utility

Arenas:

- Forest Hill Memorial Arena
- George Bell Arena
- Leaside Memorial Gardens
- McCormick Playground Arena
- Moss Park Arena
- North Toronto Memorial Arena
- Ted Reeve Arena
- William H. Bolton Arena

Community Centres:

- 519 Church Street Community Centre
- Applegrove Community Centre
- Cecil Street Community Centre
- Central Eglinton Community Centre
- Community Centre 55
- Eastview Neighbourhood Community Centre
- Harbourfront Community Centre
- Ralph Thornton Community Centre
- Scadding Court Community Centre
- Swansea Town Hall Community Centre

Business Improvement Areas:

- Bloor-Bathurst-Madison Business Improvement Area
- Bloor by the Park Business Improvement Area
- Bloorcourt Village Business Improvement Area

Bloordale Village Business Improvement Area
Bloor West Village Business Improvement Area
Bloor-Yorkville Business Improvement Area
Corso Italia Village Business Improvement Area
Danforth by the Valley Business Improvement Area
Dovercourt Village Business Improvement Area
Eglinton Way Business Improvement Area
Elm Street Business Improvement Area
Forest Hill Village Business Improvement Area
Gerrard India Bazaar Business Improvement Area
Greektown on the Danforth Business Improvement Area
Harbord Street Business Improvement Area
Hillcrest Village Business Improvement Area
Junction Gardens Business Improvement Area
Keele-Eglinton Business Improvement Area
Kennedy Road Business Improvement Area
Kingsway Business Improvement Area
Lakeshore Business Improvement Area
Little Italy Business Improvement Area
Mimico by the Lake Business Improvement Area
Mimico Village Business Improvement Area
Mount Dennis Business Improvement Area
Old Cabbagetown Business Improvement Area
Parkdale Village Business Improvement Area
Pape Village Business Improvement Area
Queen Broadview Village Business Improvement Area
Roncesvalles Village Business Improvement Area
St. Clair Gardens Business Improvement Area
St. Lawrence Neighbourhood Business Improvement Area
Upper Village Business Improvement Area
Village of Islington Business Improvement Area
Weston Business Improvement Area
Yonge-Queen-Dundas Business Improvement Area
York-Eglinton Business Improvement Area

Business Enterprises –

Enwave District Energy Limited

Toronto Economic Development Corporation

Toronto Hydro

Toronto Parking Authority

Summary of Recommendations embodied in the
report (January 2002) prepared by Mr. Denis Desautels,
entitled “Serving Council and Citizens: Strengthening
the Audit Function at the City of Toronto.”

It is recommended that City Council establish the position of Auditor General of the City of Toronto with all the essential attributes of such a position and with the staffing and resources to form the office supporting the Auditor General. This position, its attributes and obligations and those of the Audit Office should be enshrined in the provincial statutes pertaining to the City of Toronto;

- (1) the position of City Auditor with its supporting staff be reorganized into two separate positions and units: an Auditor General reporting to Council and an Internal Auditor reporting to Management;

Mandates and Reporting Structures:

- (2) the Auditor General’s mandate include:
 - (a) carrying out financial, compliance and performance (value-for-money) audits of all programmes, activities and functions of the City and its Agencies, Boards, and Commissions;
 - (b) the powers already given to City Auditors under the Municipal Act of Ontario;
 - (c) overseeing the work of the external auditors; and
 - (d) following up implementation of any resulting recommendations;
- (3) the Auditor General:
 - (a) report to Council through the Audit Committee and the Audit Committee recommend action to Council;
 - (b) not report through the administrative structure;
 - (c) prepare an annual report to Council by a prescribed date such as September 30, commenting on the trends observed, the state of control systems and on the “big picture”; and
 - (d) report on the performance of his/her office on an annual basis;
- (4) the Province be requested to change the City of Toronto Act to enshrine the Auditor General as a required position in the City along with its attributes, obligations, and supporting Audit Office;

- (5) the Internal Auditor's mandate include:
 - (a) providing management assurance that the systems for which they are responsible function properly;
 - (b) investigating situations where management have concerns; and
 - (c) reviewing the adequacy of controls in proposed new systems;
- (6) the Internal Auditor:
 - (a) become part of the Chief Administrative Officer's organization;
 - (b) keep the Audit Committee informed of its activities; and
 - (c) make all of its findings available to the Auditor General;

Independence of the Auditor General

- (7) the Auditor General have full authority to staff his/her office, to classify and promote staff, as well as engage contractors, within the City's overall rules and framework and staff should not be covered by the same collective agreements as other parts of the City;
- (8) the budget of the Auditor General's Office be approved by Council but the Auditor General should be able to spend the authorized amount in the manner he/she deems most appropriate;
- (9) the Auditor General be given latitude in accepting to carry out any special audits requested by individual Members of Council or Council itself and Council to adopt a clear set of operating rules, a convention or protocol governing such requests;

Resources

- (10) the Office of the Auditor General be established by using the appropriate resources from the current City Auditor to form the core on the new organization and recruit additional expertise to complement that of the current Audit Services group;
- (11) the Internal Audit group be composed of 8 to 10 staff and possibly more temporarily to complete backlog;
- (12) the budget:
 - (a) for the Auditor General unit be \$2,150,000 to \$2,250,000;
 - (b) for the external audit be transferred from the Finance Department to the Auditor General;

- (c) for the Internal Audit unit be \$900,000 to \$1,100,000; and
- (d) for the attest audit of smaller Agencies, Boards and Commissions be arranged differently;

such costs representing an increase in total annual budget of \$500,000.00 to \$800,000.00;

Transition Measures:

- (13) the City develop special transition measures in the process of establishing a new audit regime;

Selection:

- (14) the Auditor General:
 - (a) be selected through an impartial search process to identify candidates of the highest quality, possibly with the assistance of professional organizations such as the Institute of Chartered Accountants of Ontario;
 - (b) be appointed by Council on the recommendation of the Audit Committee; and
 - (c) be engaged under contract for a term of seven years; and
 - (d) be remunerated within a range used for other senior officials of the City, but without performance bonuses or alternatively remuneration be set through an independent committee or firm engaged to recommend a level of remuneration.

The Policy and Finance Committee submits the following report (January 17, 2002) from the Chief Administrative Officer:

Purpose:

The Mayor's Task Force on the Establishment of an Independent Auditor General engaged Denis Desautels to review the City's audit function. Mr. Desautels delivered the report dated January 2002 entitled "Serving Council and Citizens: Strengthening the Audit Function at the City or Toronto" (the AG Report). Upon receiving the final AG Report, the Mayor requested that the City CAO report to Policy and Finance on the process for implementing the recommendations of the AG Report. This staff report responds to the Mayor's request and should be considered along with the AG Report.

Financial Implications and Impact Statement:

The AG Report recommends a restructuring of the audit function at an estimated additional annual cost of \$500,000.00 to \$800,000.00. There may also be an additional cost to provide the attest audit for smaller City agencies if this function is not retained by the new Auditor General

as recommended in the AG Report. The AG Report suggests that the future benefits arising from this new function would be more than sufficient to justify this increased cost.

In the longer term, if the attest audit for the City and its major agencies is later performed by the Auditor General, as is strongly recommended as a future step in the AG Report, then there is an opportunity to somewhat reduce the costs of approximately \$1 million for this function.

These estimates have not been reviewed by City staff.

Recommendations:

It is recommended that:

- (1) if Council approves the recommendations in the AG Report “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto”, the City Chief Administrative Officer work with the City Auditor, in consultation with the City Solicitor and Commissioner of Corporate Services, to implement this strategy and report back to Council on any specific actions which may require Council approval; and
- (2) the appropriate City Officials be authorized and directed to take the necessary action to give effect thereto.

Background:

In Spring 2001, the Mayor established a Councillor Task Force on the Establishment of an Independent Auditor General and Councillor Minnan-Wong was asked to chair the Task Force, joined by Councillors Balkissoon and Prue. The Institute of Chartered Accountants of Ontario was asked to act as a steering group for this review, chaired by Mr. Thomas A. Hards. The former Auditor General of Canada, Mr. Denis Desautels, was engaged to review the current audit arrangements and develop a model which would be implemented to strengthen the current audit regime at the City.

The resulting report “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto” was submitted to the Task Force who forwarded the AG Report to the Mayor. The Mayor subsequently requested that the City CAO report on the process for implementing the recommended strategy. This report responds to that request.

Comments:

To summarize, the strategy outlined in the AG Report recommends restructuring the existing audit function into two separate groups:

- (1) a newly formed Auditor General unit reporting directly to the Audit Committee responsible for managing the attest audit performed externally and carrying out financial, compliance and performance (value for money) audits of all City programs and ABCs as s/he deems necessary to improve accountability, and improve management and control systems; and

- (2) a newly formed Internal Audit function reporting to the Chief Administrative Officer to monitor and review internal control procedures to provide assurance to the City administration that systems function as intended and new systems and procedures have the necessary checks and balances.

For the short term, the attest audit for the City core services and its major ABCs would continue to be performed by external auditors under the Auditor General's direction. However, the AG Report recommends that the attest function for smaller ABCs be performed through alternative means (not by the Auditor General) and that the attest audit be brought in-house within the Auditor General unit in future.

The AG Report also recognizes the need to perform program evaluations and suggests that these be conducted and managed within the existing program administration.

The AG Report recommends that existing staff be re-deployed to form the core of these two units and additional expertise in value-for-money auditing and effectiveness be recruited to support the Auditor General. It is also recommended in the AG Report that a search be conducted to select the Auditor General.

The AG Report estimates that the additional staff costs may be \$500,000 to \$800,000 annually, but that the benefits to accrue to the City in future as a result of this strategy would be more than sufficient to justify this additional cost.

To implement this strategy the following actions will need to be taken:

- (1) Auditor General Position:
 - (i) agree on the title;
 - (ii) detail the specific mandate and reporting structure;
 - (iii) determine the appropriate compensation (AG Report suggests an independent determination);
 - (iv) initiate a selection process (AG Report recommends assistance of ICAO to conduct search);
 - (v) agree on the initial term for a contract (AG Report suggest 7 years) and the clauses necessary to deal with contract wind-up;
 - (vi) detail "all powers necessary to carry out those responsibilities" (AG Report pg. 28);
 - (vii) define what additional authority needed by Auditor General to ensure independence (AG Report suggests discretion in establishing compensation levels, hiring practices, and contractor engagement); and

- (viii) define annual performance review process.
- (2) Internal Auditor Position:
 - (i) detail the specific mandate and reporting structure;
 - (ii) determine the appropriate compensation; and
 - (iii) selection process if needed.
- (3) Audit Services Staff:
 - (i) determine resource allocations between two units established (AG Report suggests 8-10 staff in Internal Audit); and
 - (ii) allocate to one of the two units established, considering skills, experience, preferences.
- (4) Additional Staff:
 - (i) determine the skills and experiences necessary to augment allocated staff resources in Auditor General unit;
 - (ii) develop job descriptions and compensation; and
 - (iii) initiate recruitment process.
- (5) Assets and Office Space:
 - (i) allocate office furniture, fixtures, computers, files, etc.; and
 - (ii) detail space requirements and office locations.
- (6) Budget:
 - (i) verify the budget estimates for each unit:
 - (a) Auditor General \$2,150 - \$2.250 thousand estimated in AG Report;
 - (b) Internal Audit \$900 - \$1,100 thousand estimated in AG Report;
 - (ii) obtain Council approval for budget;
 - (iii) establish accounts and budget allocations among accounts; and
 - (iv) transfer budget for attest audit from Finance to Auditor General.

(7) Legal Requirements:

- (i) develop City By-law and/or request Provincial amendment to City of Toronto Act (as recommended in AG Report) to enshrine Auditor General position;
- (ii) develop employment contract (may be different from existing standard);
- (iii) determine impact on existing contracts for other senior staff; and
- (iv) amend existing by-laws (financial, procedure, commissioners) as needed to recognize new/altered roles and reporting relationships and establish operating rules limiting requests for special audits and process for considering reports from the Auditor General including process for securing staff responses.

(8) Other:

- (i) determine appropriate method of performing attest audit for smaller ABCs; and
- (ii) establish budget.

Once Council approves the overall strategy, many of these activities can be initiated and managed by staff without further approval under recommendation 2 of this report. However, some will require specific Council approval once the details have been established and approved.

It is recommended that if Council approves the recommendations in the report “Serving Council and Citizens: Strengthening the Audit Function at the City of Toronto”, the City Chief Administrative Officer work with the City Auditor, in consultation with the City Solicitor and Commissioner of Corporate Services, to implement this strategy and report back to Council on any actions which may require specific Council approval.

Conclusion:

This report details the specific actions necessary to implement the strategy recommended in the Task Force’s AG Report and recommends that the CAO work with the City Auditor to implement the strategy when approved by Council, seeking Council approval as required for specific actions.

The Policy and Finance Committee also submits the following communication (January 30, 2002) from Mr. Michael Prue, MPP, Beaches-East York:

Recently, the press has speculated on the rationale for creating a position of Auditor General for the City of Toronto.

As a member of the Task Force set up to consider this issue, I wish to clarify exactly what transpired during the course of meetings which I attended.

First and foremost, the discussions involved hiring an Auditor General to work independently of the Audit function. It was agreed that Mr. Griffiths and his staff did exemplary work. It was not intended that the new position would detract in any way from their duties.

Secondly, the discussions to which I was privy never involved the MFP deal, as most of the details did not surface prior to my departure. Certainly they were not raised among my colleagues, nor with Mr. Denis Desautels.

Finally, the focus was process-oriented, endeavouring to create a better, more effective audit system, which would report to Council in much the same way as occurs at the Provincial and Federal levels, i.e. devoid of even a hint of interference.

As a member of the Task Force until September 2001, I supported the thrust of the recommendations; as an MPP, I still do. The purpose was - and appears to remain - to set up an effective, impartial system to monitor and highlight waste and questionable practices.

It is a good idea whose time has come.

Mr. Denis Desautels made a presentation to the Policy and Finance Committee in connection with the foregoing matter.

Ms. Louise Verity, Director of Policy, the Toronto Board of Trade, appeared before the Policy and Finance Committee in connection with the foregoing matter.

The following Members of Council also appeared before the Policy and Finance Committee in connection with the foregoing matter:

- Councillor Bas Balkissoon, Scarborough-Rouge River;
- Councillor Doug Holyday, Etobicoke Centre;
- Councillor Irene Jones, Etobicoke-Lakeshore;
- Councillor David Miller, Parkdale-High Park;
- Councillor Jane Pitfield, Don Valley West; and
- Councillor Michael Walker, St. Paul's.

(City Council on April 16, 17 and 18, 2002, had before it, during consideration of the foregoing Clause, a supplementary report (April 17, 2002) from the City Solicitor on the Proposal to Establish an Independent Auditor General for the City of Toronto.)

(Having regard that City Council deferred consideration of this Clause to its next regular meeting scheduled to be held on May 21, 2002, the aforementioned report will be resubmitted to Council.)

(City Council on May 21, 22 and 23, 2002, again had before it, during consideration of the foregoing Clause, the following supplementary report (April 17, 2002) from the City Solicitor:

Purpose:

This report provides comments on recommendations previously before Council in respect of the proposal to establish an Independent Auditor General for the City of Toronto.

Financial Implications and Impact Statement:

There are no direct financial implications arising from the recommendations in this report.

Recommendations:

It is recommended that this report be received for information.

Background:

At its meeting of February 13, 14 and 15, City Council deferred consideration of Clause No. (1) of Report No. 2 of the Policy and Finance Committee entitled "Proposal to Establish an Independent Auditor for the City of Toronto" to the April 16, 2002 meeting of City Council. In doing so, Council also deferred consideration of the January 17, 2002 report of the Chief Administrative Officer which responded to the Mayor's request that the CAO report on the process for implementing the recommendations of the report in preparation for the establishment of a City of Toronto Auditor General.

Comments:

I, together with The Chief Administrative Officer, have met to review in detail the recommendations of the Policy and Finance Committee and have also met with the Chair of the Mayor's Task Force, together with Denis Desautels, to understand the intent of the recommendations in Mr. Desautels report to the Task Force.

It was clear from the discussion with Mr. Desautels that certain of the recommendations for a City of Toronto Auditor General were not intended to be fully implemented in the short-term. There were also a few points which caused legal concern in light of applicable statutory provisions. Accordingly, if Council determines to proceed with the establishment of an Auditor-General as recommended by the Policy & Finance Committee, the following should be taken into account:

- (1) Recommendation (I)(2)(a) was not intended to include the Attest Audit function as part of the immediate mandate of the Auditor General and, accordingly, for clarity, the words*

“(excluding attest)” should be inserted into recommendation (I)(2)(a) following the word “financial”;

- (2) Recommendation (I)(14) was intended to be a long term recommendation rather than an immediate one and, accordingly, for clarity, the words “upon the expiry of the current City Auditor's term of office,” should be inserted at the beginning thereof;*
- (3) Recommendation (I)(14)(c) providing that the ultimate contract term for the Auditor General be a period of seven (7) years conflicts with the maximum five (5) year term as stipulated by the Municipal Act and, accordingly, should be amended to read five (5) years; and*
- (4) the new Municipal Act (effective from and after January 1, 2003) requires that the Auditor performing the attest audit not be an employee of the municipality and, accordingly, the suggestion from the Desautels report that the attest audit perhaps form part of the mandate of the Auditor General in the future, should not be adopted;*

Conclusions:

If Council determines to proceed with the establishment of an Auditor-General as recommended by the Policy and Finance Committee, the points noted above should be taken into account.

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