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Delivered by Hand

Ms. Daina I. Groskaufmanis
Commission Counsel
The Toronto Computer Leasing Inquiry
East York Civic Centre
850 Coxwell Avenue
Toronto ON M4C 5R1

Dear Ms. Groskaufmanis:

Re: Closing Submission - The Toronto Computer Leasing Inquiry

The attached document is in response to the issues you raised in your letter of October 21, 2003 and represents my closing submission to the Toronto Computer Leasing Inquiry.

If you wish to discuss, please contact me.

Yours very truly,

Jeff Griffiths
Auditor General

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Encl. Response to October 21, 2003 Correspondence

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August 9, 2004

Ms. Daina I. Groskaufmanis
Commission Counsel
The Toronto Computer Leasing Inquiry

Dear Ms. Groskaufmanis:

As I am sure you are aware, it is the responsibility of management to ensure that adequate internal controls exist in those areas for which they are responsible. The Auditor General is not responsible for the appropriateness and existence of internal controls across the City. If the Auditor General was responsible for the establishment of all such controls, then it follows that this responsibility would extend to internal controls not only in relation to the Year 2000 Project Office but also in such diverse areas as:

- Property Tax Revenue
- Water and Sewer Billings
- Investment administration
- Investment Income administration
- Payroll administration of 45,000 employees.
- Operation and maintenance of approximately 5,000 vehicles
- Collection of over \$50 million in recreation revenues
- Toronto Transit Commission Fare Revenue
- Toronto Transit Commission Payroll
- Parking Fine Revenues
- Toronto Police Service's Payroll
- Parking Enforcement costs
- City Grants Program
- Homes for the Aged Resident's Fees
- Building Permit Revenues
- Administration of a significant number of City-operated pension funds
- Reserve and Reserve Fund accounting and administration
- Revenue from Exhibition Place, including those generated by the annual CNE Fair
- Toronto Zoo admissions and parking revenues
- Various theatre admissions revenues
- Housing Company rentals
- Sheppard Subway project costs
- A wide range of construction contracts
- Election operations and administration

In view of the large and diverse number of administrative systems throughout the City, it is imperative that management for each of these systems be responsible for the maintenance of internal controls and not the Auditor General. This responsibility can not be assigned to one individual or one Department.

Ms. Wanda Liczyk, former Chief Financial Officer and Treasurer, in her testimony of November 12, 2003 (page 20, line 12 of the Transcript) in response to a question as to who was responsible “to ensure that good financial controls were in place, Finance or Audit”, indicated that:

“Actually, it's neither. In the main, it's actually primarily first with the business unit owner so, in this case, the prime responsibility would have been with Ms. Viinamae to have designed those controls and with -- with the understanding, of course, that if she needed additional help that she would either ask my department or the City Auditor's group to help her.”

In addition, on March 30, 2001, a report was issued by the City Auditor’s Office entitled “Management Controls: A Basic Departmental Responsibility” in which the following was reported:

“Establishing and maintaining an internal control structure is an important management responsibility. The internal control structure should be supervised by management to determine that it is operating as intended and that it is modified as appropriate for changing circumstances.

The absence of basic administrative internal controls is the most significant contributor to fraud. Internal controls must be assessed on a constant basis, particularly where circumstances and staff responsibilities change.

In this context, it is important that the Chief Administrative Officer, as a priority and in consultation with the Chief Financial Officer and Treasurer and the Commissioners, identify those administrative areas where the greatest risk exist and take appropriate steps to ensure that adequate controls are in place to prevent fraudulent activities.

The highest areas of risk are normally those areas where significant amounts of cash are handled, where high value assets including inventories, computer equipment and supplies exist and also where a significant number of transactions occur both in terms of volume, as well as individual dollar amounts. The re-evaluation of all internal controls should focus on the following:

- *Appropriate levels of supervision.*
- *An appropriate system of management review and approval.*
- *Appropriate segregation of incompatible duties where practical. In circumstances where this is not practical, compensating controls such as increased levels of supervisory review should be implemented.*

- *Appropriate physical controls over the custody of assets including inventories and equipment.*
- *Adequate and ongoing independent reconciliation and supervisory review of various accounts including:*
 - *bank accounts*
 - *receivable accounts*
 - *suspense accounts*
 - *investment accounts*
 - *employee advance accounts*
 - *inventory accounts*

The review of controls relating to each of the above should be ongoing, particularly where staff responsibilities and circumstances change. In order to ensure that this matter is addressed expeditiously, it is suggested that the Chief Administrative Officer be requested to report to the next meeting of Audit Committee on the processes in place to ensure appropriate ongoing evaluation of internal administrative controls throughout the City and the implementation of revised controls where necessary.”

The current Mission Statement of the City Finance Department specifically indicates that one of its objectives is “Maintaining Financial Controls”.

While the Auditor General has an ongoing responsibility to independently evaluate the adequacy of existing control systems by analysing and testing controls and making recommendations on how to improve controls, this responsibility is exercised in the context of those areas where the highest risk exists.

In determining areas of risk, one of the issues that has been raised is the audit my Department did relating to over-expenditures in the Information and Technology Services Division of the former City of Toronto dated June 23, 1998. This audit was conducted at the request of management and was not included in my original work plan. While these over-expenditures were not significant in the context of the materiality of the City’s expenditures (in a budget of approximately \$6.5 billion - \$1.8 million of over-expenditures in the operating accounts and \$2.6 million of over-expenditures in the capital accounts) we issued a report on this matter. One of the recommendations was that “the Chief Financial Officer and Treasurer finalize the necessary budget control processes, including the provision of effective management reports to assist departments in monitoring expenditures against budget.”

The fact that we issued a report with specific audit recommendations would not necessarily mean that we would focus our immediate future audit attention to this area, particularly as this over-expenditure related to a former, pre-amalgamation municipality. In fact to the contrary, unless our concerns were significant, the fact that we had already conducted an audit would very likely preclude us from revisiting this area for a follow-up audit for at least two years and probably longer.

In other words, the problems of over-expenditures were already identified and recommendations made which should have minimized further problems. Management is responsible for ensuring that the recommendations are implemented and complied with.

Follow up audits are a normal part of any ongoing audit process including the City of Toronto. To suggest that a follow up audit be conducted in a time frame almost immediately subsequent to the original audit, with respect, demonstrates a less than complete understanding of an effective audit process. In such circumstances, my office would be constantly conducting follow up audits.

In addition, further influencing our decision to not conduct an immediate audit follow-up, was the fact that the City Auditor's Office had made a presentation to the Information and Technology Division of the Corporate Services Department on budgeting controls in November 1998 (see attached letter dated September 12, 2003 to Mr. Pat Moore, Council, Toronto Computer Leasing Inquiry). In attendance at that presentation were Ms. Margaret Rodrigues (Commissioner of Corporate Services), Mr. Jim Andrew (Executive Director of Information and Technology), and Ms. Lana Viinamae (Director, Information and Technology Division). This presentation addressed such general issues as:

- Corporate Financial Policies and Procedures
- Management Reports and Variance Analyses
- Expectations, Role and Responsibilities

From a detailed perspective, the summary of key points raised during that presentation was as follows:

- The expectation of all Department Heads that there be no overspending.
- Program Managers must be aware of any funding adjustments.
- Budgets should be appropriately accounted for / allocated during the year.
- Staff are required to operate within established Corporate policies and by-laws.
- Before being spent or committed, appropriate funds are confirmed as being available.
- A requirement that all assumptions and supporting information must be documented.
- Before any payment is made, all goods / services must be received and confirmed.
- Each month, management information reports must be reviewed carefully.
- Key indicators must be identified, reviewed and analysed.
- Any unusual or questionable items are to be reported to management immediately.

- Year-end positions are to be carefully projected.
- Any significant issues are to be reported to the Department Head or Senior Manager and dealt with immediately.
- Staff are to give Senior Management regular status reports and identify any transitional or other issues, and develop appropriate procedures and systems to compensate for any deficiencies.
- Program Managers must be cognisant of only spending according to their budget.
- Staff are to ensure that funds over expended in one area can be offset by lower spending in another.
- Budget control is a priority using a pro-active managed process rather than a reactive approach.

A summarized outline of the presentation is in the September 12, 2003 letter to Mr. Pat Moore, (attached). As you can tell from the presentation outline, the information provided is comprehensive. Senior Managers in the City should have been aware of budgetary controls prior to the presentation. The presentation should have served to reinforce issues which were generally basic management principles.

In my view, this presentation, along with the report on over-expenditures, adequately addressed audit concerns in relation to potential over-expenditures, not only in the Information and Technology Division but also in the Corporate Services Department. The report was issued and the presentation to staff was made well in advance of the over-expenditures in relation to MFP.

In this context, even with the benefit of hindsight, I did not view an audit of the budget and variance reporting process in the Information and Technology Division as an area of concern and certainly not an audit priority. Management was very clearly aware of their internal control responsibilities.

A further issue which needs to be considered in relation to internal controls regarding the MFP transaction is the fact that, for the most part, controls were in place. The fact that these controls were not complied with is a separate and extremely important issue.

My report on management controls dated March 30, 2001, which I mentioned earlier, categorizes the key features of an effective internal control process. These features, along with my comments, are as follows:

1. Appropriate Levels of Supervision

Ms. Viinamae reported both to senior staff including Mr. Andrew, Ms. Rodrigues and, I believe in certain circumstances, Mr. Garrett. As you are aware, Ms. Viinamae also reported to the Y2K Committee. In my view, appropriate levels of supervision existed. Whether or not the adequate degree of supervision was exercised is a separate issue.

2. Appropriate System of Management Review and Approval

Individual business cases were required for the remedy of Y2K systems at the departmental level. Each of these cases required sign-off at the Manager and the Commissioner level prior to being considered by the Year 2000 Office. Further sign-off was required by Ms. Viinamae and additional approval was required by the Y2K Steering Committee. Invoices initially approved by Ms. Viinamae were subsequently approved by Mr. Al Shultz, Director, Accounting Services for the City Finance Department. Consequently, in my view, an appropriate system of management review and approval existed.

3. Appropriate Segregation of Duties

In my view, appropriate segregation of duties existed at the initial approval point and also at the disbursement point where Ms. Viinamae and Mr. Shultz were co-signatories relating to the approval of invoices. In addition, the existence of the Y2K Committee provided further segregation of duties. In certain cases, sign-off of each member of the Y2K Committee (including Mr. Garrett, Ms. Liczyk, Ms. Viinamae, Mr. Andrew, as well as Mr. Pagano) was required prior to the commitment of funds.

4. Appropriate Physical Controls Over the Custody of Assets

This was a departmental responsibility, although it is apparent that there was no central control over the assets.

5. Adequate/Ongoing Independent Reconciliation and Supervisory Review of Accounts

This is a basic financial responsibility and applies to a wide range of accounts such as bank accounts, receivable accounts, investment accounts, etc. Obviously, included in this process would be ongoing lease payments which should have been cross-referenced to individual lease contracts. I would strongly suggest that the Finance Department, which included a number of experienced Chartered Accountants, should have conducted this reconciliation process on an ongoing basis as a matter of course. Payments should not be made without ensuring that they are in accordance with supporting documentation. The Finance Department did not need direction or a recommendation from the Auditor General's Office to conduct such a standard reconciliation process, which should have been second nature to them, as well as senior managers in the Information and Technology Division.

In addition to the above, the SAP financial information system included a process to "red flag" potential overpayments. This process was disabled; a matter which was identified in some length in our report on the "Selection and Hiring of Professional and Consulting Services Review", dated June 19, 2001.

In regard to the audit of the Year 2000 Project, I have indicated on a number of occasions that our selection of audit projects is based on our review and analysis of risk. In the context of risk, the following criteria are taken into account:

- Total Expenditure
- Total Revenues
- Value of Assets
- Extent of Liabilities
- Complexity of Operations
- Management and Internal Controls
- Previous Audit History
- Extent and Complexity of Computerization
- Political Sensitivity
- Public Sensitivity

While I take full responsibility for the determination of our work plan, it was developed in consultation with my two Directors, each of whom have approximately 20 years of professional audit experience, and was based on the professional judgement of each one of us. In addition, the work plan was shared with my professional staff who collectively have many decades of audit experience. The work plan was also submitted to the Audit Committee and to City Council, who were quite at liberty to add or make amendments to the plan. In the context of audit risk, my resources and the various projects which City Council directed me to complete, I am of the professional opinion that my work plan was appropriate, even with the benefit of hindsight.

In terms of audit risk, a computer lease transaction over a three-year period, which entails an annual disbursement of approximately \$14 million would not have raised any audit concerns for the following reasons:

1. A lease agreement is a relatively straightforward transaction which, in essence, involves a monthly payment being made in accordance with a predetermined legal agreement.
2. In comparison to other transactions, annual lease payments of \$14 million were not significant relative to other major City transactions, including almost all of those areas itemized on page 1 of this report.

In addition, it is worth noting that an amount of \$42.5 million had been expended up to December 31, 1999 (the eve of the Y2K issue). The balance of the funds, approximately \$40 million, were expended subsequent to that time.

Furthermore, as you are aware, an audit is usually conducted subsequent to the transaction. In this regard, I am not sure how such an audit could have prevented the MFP over-expenditures.

In regard to the issue relating to communicating “the limited role of the Audit Office with respect to the Year 2000 Project” to “City of Toronto employees, and particularly to staff in the Year 2000 Project Office” in my opinion, this is an unfair statement. In spite of comments raised during the Inquiry by various staff concerning my Department’s perceived role in the Y2K process, this, in my view, is an attempt to obfuscate responsibility.

The usual comments made in circumstances such as this is “Audit was at the table, so everything must be OK!” Many of the individuals working at the Year 2000 Project Office, including senior staff, have been involved with Audit staff for a number of years and are completely familiar with the role of Audit. I can not emphasize enough that it is the responsibility of managers to manage. Auditors do not, for obvious reasons, become involved with the management process. To suggest, as has been the case, that my office was involved in the review and approval of invoices is ludicrous, erroneous and not borne out by the facts, and a comment I take great exception to. In my 30 years of experience in the audit field, I have never approved an invoice other than one directly relating to my Department. Auditors do not approve departmental invoices and have never done so.

It is my view, that in spite of what has been said at the Inquiry, senior staff at the City were very much aware of Audit’s role on the Y2K project. In summary, I draw your attention to a report written by Shirley Hoy, the Chief Administrative Officer, and sent to the Audit Committee dated November 16 2001, entitled “Management of Consultants – Policy and Implementation Plan” wherein she states as follows:

*“The role of the City Auditor is clearly understood by the Chief Administrative Officer and the Executive Management Team. The City Auditor reports to City Council through the Audit Committee and has the authority to conduct financial, operational, compliance, information systems, forensic and other special reviews of all departments, agencies, offices, boards, commissions as well as other entities the City is related to or has an interest. The City Auditor does not approve invoices and contracts and does not monitor expenses for City departments. However, there was confusion on the part of **some** (bolded added) staff regarding the City Auditor function in the Year 2000 Project. His consultative role was misinterpreted as having direct authority to approve invoices, which was incorrect.”*

I would strongly suggest that if the Chief Administrative Officer and the Executive Management Team knew what the role of the City Auditor was, I find it difficult to comprehend that staff at one level lower did not. With all due respect to the staff involved, this to me seems to be a misinterpretation of the facts for convenience. This misinterpretation has no basis and is inconsistent with the role of Audit at the City and the former municipalities for many years previous.

In addition, specific comments have been made concerning the fact that the Audit Department had access to all documentation in existence at the Year 2000 Office. In actual fact, as the City Auditor I had, and continue to have, access to all documentation throughout the City. Such access is paramount to an audit role in any entity and to suggest that my access to Y2K documentation was in some way unusual is again naïve and a misstatement of the facts.

In conclusion, the role of the Auditor General of Canada and its direct comparison to the role of the Auditor General of the City of Toronto is of particular relevance to the issues raised in the October 21, 2003 letter forwarded to me.

The Auditor General of Canada has received significant prominence in connection with her review of various sponsorship payments. These sponsorship payments occurred over a significant period of time and involved large amounts of expenditures. Based on her review of the expenditures, it is readily apparent that internal controls were almost non-existent over these disbursements. The Auditor General of Canada had no responsibility in ensuring that such controls existed, but rather her role is in the evaluation of such controls and ensuring that recommendations are made which prevents such situations from reoccurring. This is a role which parallels the role of the Auditor General of the City of Toronto.

I welcome the final report of the Commissioner and hope that the issues I have raised are considered.

Yours very truly,

Jeff Griffiths
Auditor General

Attached: Letter to Mr. Pat Moore, Council, Toronto Computer Leasing Inquiry - dated
September 12, 2003

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