Clause embodied in Report No. 1 of the Audit Committee, as adopted by the Council of the City of Toronto at its meeting held on February 13, 14 and 15, 2002.

1

Status of Litigation with MFP Financial Services

(City Council on February 13, 14 and 15, 2002, adopted the following recommendations:

"It is recommended that:

(1) City Council request that a Public Inquiry in respect of the MFP contracts be held under Section 100 of the Municipal Act, and, in accordance with the report (February 12, 2002) from the City Auditor, the following Resolution provided by external counsel and incorporating the recommended Terms of Reference be passed, as amended by Council:

Being a Resolution to Request a Judicial Inquiry Pursuant to Section 100 of the Municipal Act and to Provide the Terms of Reference Therefor

***WHEREAS**, under section 100 of the Municipal Act, R.S.O. 1990 c. M.45, a Council of a municipality may, by resolution, request a Judge of the Ontario Court (General Division), now the Superior Court of Justice, to inquire into or concerning any matter connected with the good government of the municipality, or the conduct of any part of its public business; and*

***WHEREAS** any Judge so requested shall make inquiry and shall report with all convenient speed, to Council, the result of the inquiry and the evidence taken, and for that purpose shall have all the powers of a commission under Part II of the Public Inquiries Act, R.S.O. 1990 ch. P. 41; and*

***WHEREAS** on approximately January 1, 1998, computer equipment acquired for the newly elected City Councillors' offices was leased from MFP Financial Services Ltd. ("MFP") for a three year term pursuant to a Master Equipment Lease Agreement numbered "784" and subsequently by equipment schedules under the Master Agreement for assets totaling approximately $1,093,731; and*

***WHEREAS** there is no written documentation that the procurement of the equipment was lawfully approved or that a competitive process was followed in awarding the leasing contract to MFP; and*

***WHEREAS** in early 1999 staff were exploring financing options for the large-scale software and computer acquisitions anticipated as necessary to deal with what is commonly referred to as the "Y2K problem" and a Request for Quotations ("RFQ") was issued in May 1999 to solicit bids for computer leasing; and*

***WHEREAS** pursuant to a report from the City's then Chief Financial Officer and the City's then Executive Director, Information Technology, Council approval was obtained to lease $43 million of computer and related equipment by the adoption of Clause No. 11 of Report No. 4 of the Policy and Finance Committee at Council's meeting of July 27, 28, 29 and 30, 1999; and*

***WHEREAS** the report indicated to Council that the bid by MFP was the preferred bid and Council authorized the City of Toronto to enter into a leasing contract with MFP for three years; and*

***WHEREAS** the report to Council failed to mention that the rates quoted in the responses to the RFQ were only in effect for 90 days, and further, the report also failed to mention that MFP's submission did not properly clarify the rates beyond 90 days as part of the required submission of the Request for Quotations (RFQ) conditions, and staff entered into a Master Equipment Lease Agreement and a Program Agreement after the 90 day period expired, which agreements contemplated various Equipment Schedules to the Master Equipment Lease Agreement that would identify the equipment to be leased and lease terms and rates in respect of the equipment; and*

***WHEREAS** in the fall of 1999, staff initiated a sale and lease back transaction with MFP of the City's computer equipment which had been bought prior to the Council authority of July 1999 and there was no mention of a sale and lease back to be bid on in the RFQ and no authorization of a sale and lease back was sought in the report to Council; and*

***WHEREAS**, through the execution by staff of Equipment Schedules, the City has leased up to $85 million of computer equipment although the Council approval indicated an estimated cost of acquisition of $43 million of equipment; and*

***WHEREAS** with two exceptions, the initial Equipment Schedules were not for three years as approved by Council, but were for longer terms, most commonly five years and in the summer of 2000 a number of the equipment leases were restructured to extend the term of some of the Equipment Schedules beyond even the five year period; and*

***WHEREAS** the report to Council indicated that the preferred bid by MFP contained an implicit interest rate of 4.6% and the Equipment Schedules executed by City staff contained lease rates with implicit interest rates significantly in excess of the 4.6% interest rate; and*

***WHEREAS** in or about December 1999, the City's Director of the Y2K Project recommended the acquisition by the City of 10,000 Oracle Database enterprise software licences, the acquisition was approved by the City's then Y2K Steering Committee, with subsequent approval by the City's then Chief Administrative Officer, and the 10,000 licences were then acquired by lease through MFP by the addition of an Equipment Schedule to MFP's Master Equipment Lease Agreement; and*

***WHEREAS** the acquisition of the 10,000 Oracle licences was a serious miscalculation and it is unclear as to whether such acquisition was co-ordinated with the City's agencies boards and commissions, why leasing was undertaken as opposed to the continued purchase of the licences directly from Oracle and how MFP was selected for leasing of the Oracle software; and*

***WHEREAS** the concerns of the City in respect of the MFP and Oracle transactions are more fully detailed in the attached reports from the Chief Administrative Officer and City Auditor, dated respectively in respect of the MFP transactions and the Oracle transaction, November 29, 2001 and February 6, 2002 and in respect of the 1998 computer lease numbered "784", the report from the City Auditor, dated January 28, 2002; and*

***WHEREAS** the public inquiry would permit (i) the Commissioner to investigate the existence of any malfeasance, breach of trust or misconduct, (ii) the Commissioner to make recommendations that would be a benefit for the future conduct of the public business of the City, and (iii) the public to understand and evaluate fully the above noted transactions; and*

***NOW THEREFORE** the Council of the City of Toronto does hereby resolve that:*

(1) an inquiry is hereby requested to be conducted pursuant to section 100 of the <u>Municipal Act</u> which authorizes the Commissioner to inquire into, or concerning, any matter related to a supposed malfeasance, breach of trust or other misconduct on the part of a member of council, or an officer or employee of the City or of any person having a contract with it, in regard to the duties or obligations of the member, officer, or other person to the corporation or to any matter connected with the good government of the municipality, or the conduct of any part of its public business, and

(2) the Honourable Chief Justice Lesage, Chief Justice of the Superior Court of Ontario, be requested to designate a judge of the Superior Court of Ontario as Commissioner for the inquiry and the judge so designated is hereby authorized to conduct the inquiry;

***AND IT IS FURTHER RESOLVED THAT** the terms of reference of the inquiry shall be:*

To inquire into all aspects of the above transactions, their history and their impact on the ratepayers of the City of Toronto as they relate to the good government of the municipality, or the conduct of its public business, and to make any recommendations which the Commissioner may deem appropriate and in the public interest as a result of his inquiry.

AND IT IS FURTHER RESOLVED THAT *the Commissioner, in conducting the inquiry into the transactions in question to which the City of Toronto is a party, is empowered to ask any questions which he may consider as necessarily incidental or ancillary to a complete understanding of these transactions;*

and, for the purpose of providing fair notice to those individuals who may be required to attend and give evidence, without infringing on the Commissioner's discretion in conducting the inquiry in accordance with the terms of reference stated herein, it is anticipated that inquiry may include the following:

(a) an inquiry into all relevant circumstances pertaining to the various transactions referred to in this resolution, including the relevant facts pertaining to the various transactions at the relevant time as contained in the reports dated November 29, 2001, February 6, 2002 and January 28, 2002, the basis of and reasons for making the recommendations for entering into the subject transactions and the basis of the decisions taken in respect of the subject transactions;

(b) an inquiry into the relationships, if any, between the existing and former elected and administrative representatives of the City of Toronto and the existing and former principals and representatives of MFP and Oracle at all relevant times; and

(c) an inquiry into any professional advice obtained by the City of Toronto in connection with the subject transactions at the relevant times.';

(2) the Chief Administrative Officer, in consultation with the Acting City Solicitor, be requested to submit a report to the Budget Advisory Committee on funds up to $2.0 million for a Public Inquiry, as outlined in the report dated January 30, 2002, from the City Solicitor, addressed to the Audit Committee;

(3) City Council adopt the report dated December 20, 2001, from the Chief Administrative Officer, embodying the following recommendation:

'It is recommended that Council approve the Minutes of Settlement as recommended by the City's external counsel, Mr. Alan Lenczner, and upon approval of the Minutes of Settlement authorize the public release of the attached backgrounder, the backgrounder being in essence the contents of the prior in camera report, dated November 29, 2001, pertaining to the facts of the City's review of the MFP Financial Services computer leasing contract modified to delete any information pertaining to staff behaviour which is the subject of ongoing investigation as directed by Council.',

subject to the following amendments to the Minutes of Settlement:

(a) the Minutes of Settlement include that releases will be given to MFP by the City, releasing all of its officers, directors, employees and assignees from any further claim, with the exception of any claim for fraud, malfeasance, or any breach of trust, and subject further to such Settlement including provisions that should fraud, malfeasance or any breach of trust be found on the part of any of MFP's officers, directors, employees and assignees by a public inquiry, then the Settlement is null and void and the law suit would proceed;

(b) MFP agrees to rewrite the Oracle contract so that the City of Toronto is required to pay only for those licences actually used;

(c) the current leases can be renegotiated at the City's option to facilitate reduction of the lease time frame and the City's ultimate costs of the existing leases, and further, the appropriate City staff be directed to report to Council, through the appropriate Committee, on a reassessment of the lifespan of the leases, overall costs, no maintenance period, equipment retirement with payments outstanding, and whether it is beneficial to renegotiate any sections of the existing leases; and

(d) MFP agrees to provide the City of Toronto with any additional documentation or staff deliberations made or undertaken with respect to MFP transactions;

(4) in the event the Settlement offered by the City of Toronto is not accepted by MFP Financial Services Ltd., the following actions approved by City Council be undertaken:

(a) the Acting City Solicitor submit a report to the Audit Committee and the Administration Committee as soon as possible;

(b) the Acting City Solicitor amend the pleadings in the litigation with MFP to seek rescission of the Oracle leasing contact with MFP;

(c) the Chief Financial Officer and Treasurer remit payments to MFP upon advice of legal counsel to reduce further interest costs;

(d) the implementation of the following recommendations adopted by Council, as contained in the confidential joint report dated February 7, 2002, from the Chief Administrative Officer and the City Auditor, such joint report to remain confidential in accordance with the provisions of the <u>Municipal Act</u>, having regard that it concerns the security of the property of the municipality and pertains to litigation, save and except the recommendations embodied therein:

'It is recommended that:

(1) if Council decides to proceed with litigation against MFP, then staff be authorized to spend up to $5.76 million for costs resulting from litigation;

(2) funding in the amount of $4 million be made available from the 2001 Operating Surplus to be set aside as a contingency pending the outcome of any litigation and/or inquiries;

(3) the Chief Financial Officer and Treasurer report back to Council with additional funding sources for costs in excess of $4 million that result from litigation; and

(4) the appropriate City officials be authorized and directed to take the necessary actions to give effect thereto.';

(e) the implementation of the following recommendations adopted by Council, as contained in the confidential joint report dated February 13, 2002, from the Chief Administrative Officer and the Commissioner of Corporate Services, such joint report to remain confidential in accordance with the provisions of the Municipal Act, having regard that it concerns the security of the property of the municipality and pertains to litigation, save and except the following recommendations embodied therein:

'It is recommended that:

(1) direct settlement of the outstanding accounts totalling about $1.9 million by the City with suppliers of technology-related acquisitions, where such acquisitions were made prior to last year's freeze on new leases but were not financed through leasing, be approved;

(2) the appropriate staff be directed to settle these outstanding accounts with advice from the Acting City Solicitor and the external solicitor for the MFP review;

(3) the Emergency Technology Acquisition Reserve Fund be made available as internal financing for these acquisitions. The repayment of the Fund be structured with the acquiring departments under the same terms and conditions already established for the administration of the Reserve Fund. The internal repayments will begin in 2002; and

(4) authority be granted for the introduction of any Bills that are required.';

(5) the Chief Financial Officer and Treasurer be directed to hold $9 million in trust until the issue of fraud, malfeasance and breach of trust is resolved;

(6) City Council request the Provincial Government to re-establish 'Project 80';

(7) the Chief Administrative Officer be requested to submit a report to the Administration Committee outlining the efforts made by City staff to monitor the Y2K initiative, what the policies were put in place in that regard, and the enforcement mechanisms implemented to ensure the Y2K process was administered efficiently;

(8) City Council adopt the report (January 28, 2002) from the City Auditor respecting the Leasing Contract between the City of Toronto and MFP Financial Services, embodying the following recommendations:

> *'It is recommended that the Chief Financial Officer and Treasurer, in consultation with the Commissioner of Corporate Services, ensure that the Corporate financial manual currently being developed by the Finance Department include the following requirements:*
>
> *(a) for all lease transactions a comprehensive financial analysis be prepared justifying the decision to lease;*
>
> *(b) for all expiring lease agreements, a detailed financial analysis be prepared justifying the decision to either retain such equipment, extend the lease, or exercise any purchase option;*
>
> *(c) for any lease agreements which may be renegotiated during its term, a detailed analysis be conducted outlining the financial implications of the renegotiations; and*
>
> *(d) all such financial analyses be subject to appropriate supervisory review.';*

(9) the following motion be referred to the Chief Administrative Officer for further consideration after the Public Inquiry has been concluded:

> *Moved by Councillor Ford:*
>
> > *'It is recommended that the RCMP be requested to undertake an investigation into this matter.'; and*

(10) the report (February 5, 2002) from the City Auditor respecting an update on MFP Financial Services be made public.")

(City Council at its Special Meeting held on December 20, 2001, did not conclude consideration of this matter.)

The Audit Committee:

(1) submits this matter to Council without recommendation; and

(2) recommends that, in accordance with the <u>Municipal Act</u> discussions pertaining to this matter be held in camera, having regard that the subject matter is subject to litigation or potential litigation, including matters before administrative tribunals, affecting the municipality or local board.

The Audit Committee reports, for the information of Council, having requested:

(1) the Mayor to call a special meeting of City Council during the week of December 17 – 21, 2001;

(2) the City's outside legal counsel to submit a report to the special meeting of Council respecting the status of litigation with MFP Financial Services; and

(3) the City Auditor and the Chief Administrative Officer to report to the Audit Committee, at its meeting to be held on February 8, 2002 on how a City employee fraud/waste hotline could be implemented in the City of Toronto, similar to other large municipalities.

The Audit Committee further reports, for the information of Council, having issued confidential instructions to the City's outside legal counsel and to the Chief Administrative Officer, such instructions to remain confidential having regard that the subject matter of the instructions may be subject to litigation or potential litigation, including matters before administrative tribunals, affecting the municipality or local board.

The Audit Committee further reports, for the information of Council, having received a confidential verbal report from the Chief Administrative Officer and the City's outside legal counsel respecting Negotiations with MFP Financial Services.

(City Council at its Special Meeting held on December 20, 2001, had before it, during consideration of the foregoing Clause, the following:

(i) (December 20, 2001) confidential report from the Chief Administrative Officer, entitled "Resolution of Outstanding Issues Between the City of Toronto and MFP Financial Services - Computer Leasing Contract Backgrounder", such report now public in its entirety;

(ii) (Undated) confidential document entitled "Terms of Settlement" submitted by City of Toronto external counsel, Mr. Alan Lenczner, such document now public in its entirety;

(iii) (Undated) confidential document entitled "Minutes of Settlement", such document now public in its entirety;

(iv) (December 20, 2001) confidential report from the Chief Administrative Officer and Acting Chief Financial Officer, entitled "Total Lease Costs Compared with Debenturing of Computer Equipment", such report now public in its entirety;

(v) (Undated) chart submitted by the Executive Director, Information Technology, outlining the equipment delivered and in use, under lease, and not under lease; and

(vi) (December 20, 2001) communication from Charles Campbell, Glen Campbell Barristers and Solicitors, addressed to Councillor Layton, with respect to a hypothetical question regarding conflict of interest, submitted by Councillor Layton.)

(City Council also had before it, during consideration of the foregoing Clause, the following confidential documents, previously considered by Council at its regular meeting held on December 4, 5 and 6, 2001, [Audit Committee Report No. 10, Clause No. 11], such documents having been made public, in their entirety, at the Special Meeting of Council held on December 20, 2001:

(i) (November 29, 2001) joint report from the Chief Administrative Officer and City Auditor, addressed to the Audit Committee, entitled "Review of Computer Leasing Contract Between the City of Toronto and MFP Financial Services";

(ii) (December 3, 2001) joint report from the Chief Administrative Officer, the Commissioner of Corporate Services, and the City Solicitor, addressed to City Council, entitled "Potential Litigation Between Toronto and MFP Financial Services - Clause No. 11 of Report No. 10 of The Audit Committee"; and

(iii) (December 5, 2001) report from the City Solicitor, addressed to City Council, entitled "Public Release of Information Contained in the In Camera Report of the Chief Administrative Officer and City Auditor".)

(Having regard that City Council did not conclude consideration of this matter, the aforementioned reports and communications will be resubmitted to a future meeting of Council.)

(City Council on February 13, 14 and 15, 2002, had before it, during consideration of the foregoing Clause, the following communication (February 11, 2002) from the City Clerk:

Committee Action:

The Audit Committee:

(1) recommends that the City Auditor, in consultation with the Chief Administrative Officer and external counsel, develop recommended Terms of Reference for a public inquiry in respect of the MFP contracts and related matters;

(2) recommends that the report (January 28, 2002) from the City Auditor respecting Leasing Contract between City of Toronto and MFP Financial Services – Councillors Computer Equipment be adopted; and

(3) submits under separate cover the confidential reports (February 5, 2002) from the City Auditor and (February 7, 2002) from the Chief Administrative Officer and City Auditor to City Council for consideration, with the request that the report (February 5, 2002) from the City Auditor respecting MFP Financial Services - Update be made public;

The Audit Committee reports, for the information of Council, having:

(1) requested the external counsel provide to City Council, at its meeting to be held commencing February 13, 2002 a draft resolution for its consideration which would allow for commencement of an inquiry under Section 100 of the Municipal Act;

(2) instructed the City Auditor to immediately advise all Members of Council of Recommendation No. (1) above and that any submissions made to the City Auditor, the Chief Administrative Officer and external counsel by any Member of Council with respect to the Terms of Reference must be in writing;

(3) received the communication (January 29, 2002) from the Commissioner of Council Services and City Clerk, City of Windsor, responding to the City Clerk's communication of December 13, 2001 respecting Audit Report No. 10, Clause11 titled, "Review of Computer Leasing Contract Between City of Toronto and MFP Financial Services; and

(4) adjourned its public session, in accordance with the Municipal Act, to meet in Camera to consider the confidential reports (February 5, 2002) from the City Auditor and (February 7, 2002) from the Chief Administrative Officer and City Auditor having regard that the subject matter is subject to litigation or potential litigation, including matters before administrative tribunals, affecting the municipality or local board.

Recommendation No. (1) and Action No. (1) carried unanimously as follows:

Yeas: Councillors Balkissoon, Bussin, Holyday, Milczyn and Minnan-Wong – 5

The request to the City Auditor (Action No. (2)) carried on the following division of votes:

Yeas: Councillors Balkissoon, Bussin, Holyday, Milczyn – 4
Nays: Councillor Minnan-Wong - 1

Background:

The Audit Committee, on February 8, 2002, had before it the following reports/communication:

- (January 30, 2002) from the City Solicitor respecting Review of Computer Leasing Contract with MFP Financial Services Public Inquiry under Section 100 of the Municipal Act, and recommending that this report be received for information;

- *(January 28, 2002) from the City Auditor respecting Leasing Contract Between City of Toronto and MFP Financial Services – Councillors Computer Equipment, and recommending that the Chief Financial Officer and Treasurer, in consultation with the Commissioner of Corporate Services ensure that the Corporate financial manual currently being developed by the Finance Department include the following requirements:*

  (a) for all lease transactions a comprehensive financial analysis be prepared justifying the decision to lease;

  (b) for all expiring lease agreements, a detailed financial analysis be prepared justifying the decision to either retain such equipment, extend the lease, or exercise any purchase option;

  (c) for any lease agreements which may be renegotiated during its term, a detailed analysis be conducted outlining the financial implications of the renegotiation; and

  (d) all such financial analyses be subject to appropriate supervisory review;

- *(February 5, 2002) from the City Auditor - Confidential report respecting Review of Computer Leasing Contracts between City of Toronto and MFP Financial Services – Update, having regard that the subject matter is subject to litigation or potential litigation, including matters before administrative tribunals, affecting the municipality or local board;*

- *(February 7, 2002) from the Chief Administrative Officer and City Auditor - Confidential report respecting MFP Contract Review Costs having regard that the subject matter is subject to litigation or potential litigation, including matters before administrative tribunals, affecting the municipality or local board; and*

- *(January 29, 2002) from the Commissioner of Council Services and City Clerk, City of Windsor, responding to the City Clerk's communication of December 13, 2001 respecting Audit Report No. 10, Clause11 titled, "Review of Computer Leasing Contract Between City of Toronto and MFP Financial Services.*

The Audit Committee's recommendations and actions are noted above.

(Report dated January 30, 2002, addressed to the Audit Committee, from the City Solicitor.)

Purpose:

The purpose of this report is to report through the Audit Committee to Council in order to provide information on the option of a public inquiry under section 100 of the Municipal Act as background for Council's decision-making at its meeting on February 13, 2002.

Financial Implications and Impact Statement:

There are no financial implications by the receipt of this report.

Recommendation:

It is recommended that this report be received for information.

Background:

At its meeting of December 4, 5, and 6, 2001, in considering the matter of the computer leasing contract with MFP Financial Services ("MFP"), Council requested the City Solicitor to submit a report to the Audit Committee no later than April 2002 on whether a public inquiry should be instituted pursuant to section 100 of the Municipal Act ("section 100 public inquiry") with respect to the review of the contract and any related matters identified by the Chief Administrative Officer, the City Auditor and the Commissioner of Corporate Services. As it is apparent that the issue of a public inquiry will be before the February 13, 2002 Council meeting, the Chief Administrative Officer requested the City Solicitor to report through the Audit Committee in time for the meeting of February 13th and to canvass for the information of councillors the various options that could be available for further investigation or inquiry. The Chief Administrative Officer has also requested that the report address the potential costs of a section 100 public inquiry.

Comments:

The issue of whether a section 100 public inquiry should be instituted or not is a matter which Council itself needs to determine. That determination can take into account the information provided to date by the City Auditor and external counsel as a result of the reviews undertaken by both the City Auditor and KPMG as well as any recommendations by the City Auditor and external counsel. This report discusses, as requested for the information of Council, the various options that were looked at as possible avenues for further investigation or inquiry by the City into the matters surrounding the MFP computer leasing contract and then focuses on the particular issues associated with a section 100 public inquiry.

The various statutory provisions that are referred to in the body of this report are set out in the attached Appendix A.

(i) Investigation or Inquiry Options

The options available to Council are as follows:

(1) Continue with the City's Current Internal Audit and Forensic Investigation

The internal investigation is currently ongoing by the City Auditor in conjunction with that of KPMG, which is under retainer to the City's external counsel, Alan Lenczner of Lenczner Slaght. Council, at its meeting of December 4, 5 and 6, 2001, adopted a recommendation that the Chief Administrative Officer and City Auditor continue the investigation of the matter and report to the Audit Committee in April, 2002. In addition, Council requested the City Auditor as follows:

"(3) the City Auditor be requested to:

(a) undertake the further investigations, as instructed by City Council at the in-camera portion of its meeting; and

(b) continue to investigate and report to the Audit Committee on:

(i) purchase or lease of Council original equipment (IT) and the whereabouts of this equipment;

(ii) whether the City had been reimbursed for this equipment;

(iii) whether proper approvals for the actions were received; and

(iv) details surrounding the acquisition of this equipment by the Toronto Transition Team, such as the minutes of meetings, the bid process, bid proposals, the authorization of the Purchase Orders, the signatures on the contract and the interest rates on this contract or contracts;"

The City Auditor advises that, at present, his investigation is focusing on the acquisition of the Council original equipment in 1997,i.e., in accordance with the direction contained in Recommendation 3(b) above.

As one of its options, Council could determine to await the conclusion of the current internal investigation and assess then whether no action should be taken, a public inquiry is warranted or the police should be requested to investigate with a view to whether a criminal offence, in particular breach of trust or municipal corruption, has occurred.

(2) Follow up with the Request for a Provincial Municipal Audit

Under subsection 9(1) of the Municipal Affairs Act, Council can by resolution request the Ministry of Municipal Affairs and Housing to conduct a municipal audit of the financial affairs of the municipality. If the Province chose to do so, it would then appoint an officer of the Ministry or other person to undertake the audit.

Unlike the City's internal investigation, the auditor would have the power to require the production of all or any books, records and documents that might relate in any way to the affairs of the municipality that are the subject of the audit and to require any person to appear before him or her to give evidence under oath touching any of the inquiry matters. The auditor would have all the powers of a commission under Part II of the Public Inquiries Act.

Part II of the Public Inquiries Act provides for such matters, among others, as the issuance of a summons to any person to give evidence or produce any document, the power to compel such attendance or production, the rights of witnesses, the ability of an auditor to appoint an investigator and the ability to apply for search warrants.

Such municipal audits are rare, would likely be restricted to a financial review and are not public or typically publicized. The costs would be fixed and charged back to Toronto.

At its meeting of December 4, 5 and 6, 2001, by the adoption of Clause No. 11 of Report No. 10 of the Audit Committee, Council requested the Province of Ontario and the Minister of Municipal Affairs to conduct a Provincial municipal audit of the computer leasing contract with MFP. In accordance with that direction, a formal request has been submitted to the Premier's Office and the Minister of Municipal Affairs and Housing. At the date of writing, while there has been an acknowledgement of receipt, the Province has not replied to the request.

It is unlikely that the request will be granted unless the Province believes there is a provincial interest involved. A ratepayers group in the City of Waterloo had requested such a municipal audit in respect of Waterloo's contract with MFP relating to Waterloo's RIM Park, but that request has been denied on the basis of ongoing litigation. It is likely that the same reasoning would apply in Toronto's case. In addition, given the issue of possible misconduct raised by some council members, there are matters of procedural fairness that would warrant a hearing and attendant judicial expertise to safeguard the rights of parties.

(3) Request an Investigation or Inquiry by the Ontario Municipal Board

Under section 54 of the Ontario Municipal Board Act ("OMB Act"), the Ontario Municipal Board has the jurisdiction and power to inquire at any time into any or all of the affairs, financial and otherwise of a municipality. It may hold hearings and make such investigations as may appear necessary or expedient to be made in the interest of the municipality, its rate-payers, inhabitants and creditors and "particularly to make and hold such inquiries, hearings and investigations for the purpose of avoiding any default or recurrence of a default of any municipality in meeting its obligations".

There are no recent cases indicating the use of this power by the Board. The origin of the section likely arises from the financial supervisory role of the Board at a time historically when municipalities were in financial difficulty. That role is outdated as evidenced by it being superseded by the financial limit regulations under the OMB Act. Given:

(a) the contractual nature of the issues involved specifically with MFP, i.e., the matter of contract management, coupled with the issue of possible wrongdoing, all of which lends itself to the need for judicial expertise and protections;

(b) the expertise of the Board being essentially focussed on planning and assessment matters;

(c) that the Board, if it was so inclined to consider an inquiry, would, in any event, likely hold a hearing on the necessity of an inquiry, with attendant delay; and

(d) the Board, rather than Council, would likely determine the extent of any inquiry or investigation;

any Council directive to proceed with an inquiry by public hearing should be by way of either a provincial or municipal public inquiry.

(4) Request a Provincial Inquiry

Under the Public Inquiries Act, the Lieutenant Governor in Council may appoint by commission one or more persons to conduct a public inquiry. The Lieutenant Governor in Council may do so where the Lieutenant Governor in Council considers it expedient concerning any matter connected with or affecting the good government of Ontario or the conduct of any part of the public business of the government or that the Lieutenant Governor in Council declares to be a matter of public concern and the inquiry is not regulated by any special law.

Accordingly, the Province could establish a provincial public inquiry if it felt that the contractual matters affecting Waterloo, Windsor and Toronto affected provincial government and interests. It is unlikely that the Province would be able to declare the matters involved solely in Toronto's MFP computer leasing contract as a matter of provincial or public concern and subject to a provincial inquiry as, arguably, the specific matter is governed by special law, i.e., the provisions of section 100 of the Municipal Act relating to municipal public inquiries.

Even if a provincial public inquiry were possible involving more than one municipality's contract with MFP, there are concerns that, while on the one hand, Toronto could thereby share the inquiry costs, Toronto could be caught up in costs and delays as a result of the legal issues and challenges specific to other municipalities.

(5) Request a Section 100 Municipal Inquiry

Subsection 100(1) of the Municipal Act states as follows:

> *"100(1) Where the council of a municipality passes a resolution requesting a judge of the Ontario Court (General Division) to investigate any matter relating to a supposed malfeasance, breach of trust or other misconduct on the part of a member of the council, or an officer or employee of the corporation, or of any person having a contract with it, in regard to the duties or obligations of the member, officer, employee or other person to the corporation, or to inquire into or concerning any matter connected with the good government of the municipality or the conduct of any part of its public business, including any business conducted by a commission appointed by the municipal council or elected by the electors, the judge shall make the inquiry and for that purpose has all the powers of a commission under Part II of the Public Inquiries Act, which Part applies to such investigation as if it were an inquiry under that Act, and the judge shall, with all convenient speed, report to the council the result of the inquiry and the evidence taken."*

Under this section, Council may pass a resolution mandating a public inquiry, i.e., upon receipt of the request a judge must conduct a public inquiry. The resolution would set out the scope of the inquiry. The potential scope of the inquiry is wide-ranging, given that it may be very specific to a matter of misconduct or may concern "any matter connected with the good government of the municipality or the conduct of any part of its public business".

As indicated above in respect of a provincial municipal audit, Part II of the Public Inquiries Act provides for such matters, among others, as the issuance of a summons to any person to give evidence or produce any document, the power to compel such attendance or production, the rights of witnesses, the ability to appoint an investigator and the ability to apply for search warrants. A public hearing would take place and the rules of procedural fairness would apply.

A number of points need to be made about the municipal inquiry:

(a) Council has the ability, by its requesting resolution, to control the scope of the inquiry; at the same time, the resolution must be carefully crafted as it constitutes the terms of reference or mandate binding the inquiry judge in the conduct of the inquiry as well as notification of the subject matter to potential parties. The resolution must have sufficient particularity as there have been a number of cases where the requesting resolution has been quashed by the courts because the resolution was too vague;

(b) The conduct and the procedure to be followed on an inquiry is under the control and direction of the inquiry judge. The inquiry judge may appoint his or her own inquiry counsel and any investigators felt necessary. A time limit cannot be established for the inquiry given that section 100 of the Municipal Act addresses the time element by stating that the inquiry judge shall report "with all convenient speed" on the result of the inquiry and the evidence taken; and

(c) Any person who has a substantial and direct interest in the subject matter of the inquiry is entitled to standing at the inquiry with the ability to call and examine witnesses relevant to the person's interest. The City could appoint its own counsel to represent it as commission counsel would not be taking instructions from the City.

(ii) Costs and Timing of a Section 100 Public Inquiry

Subsection 100(3) of the Municipal Act is explicit that the municipality pays the inquiry judge's expenses of the inquiry, i.e., the engagement of inquiry counsel, assistants, investigators, or other expenses that the inquiry judge considers advisable for the proper conduct of the inquiry.

One of the issues that Council will need to address is whether the City will pay the costs of employee representation at the inquiry or by its terms of reference give discretion for the payment of costs or provision of funding to parties by the inquiry judge.

It is difficult to estimate the potential costs of an inquiry hearing. Two recent inquiries were the Sarnia inquiry, an inquiry under section 100 of the Municipal Act and the Walkerton inquiry, being a provincial inquiry under the Public Inquiries Act. The first inquiry was held in 1998 and concerned a series of land transactions in the former Town of Clearwater before its amalgamation into Sarnia. The inquiry involved 33 hearing days. The total cost of the inquiry was approximately $600,000. There were additional costs of approximately $400,000 in connection with various court challenges all the way to the Supreme Court of Canada.

The well-known Walkerton inquiry, which just issued its Part 1 report, had a broad mandate concerning the contamination of water in the Town of Walkerton. The provincial inquiry involved 95 hearing days and a combined total of 145 hearing days and public meetings. The total cost, as reported, was $9.5 million.

It is difficult to estimate the costs of any inquiry in advance but a range of $1 million to $2 million (and more likely closer to $1 million) can be expected for the inquiry itself relating only to the MFP transactions that are currently the subject of the settlement discussions before Council. The basis and assumptions for this dollar range are set out in Appendix B to this report.

On the issue of the time-line of any inquiry, it is estimated that the time from the passage of the requesting resolution to the submission of a report would be approximately 9 to 12 months. This estimate is based on the fact that the Sarnia inquiry, which was concerned with more of a transactional subject matter similar to that involved here, had a time-line of approximately 9 months with 33 hearing days. There were 38 witnesses and 106 exhibits.

In the late 1970's, a public inquiry, the Risdon inquiry, was conducted pursuant to the request of the former City of Toronto. That inquiry related to allegations of misconduct by the then Chief Plumbing Inspector for the City. Again, the time-line from requesting resolution to submission of report was approximately 9 months. The inquiry involved 29 hearing days, 69 witnesses and 326 exhibits.

Overall, it is estimated that the hearing itself would take place over a period of 1½ to 2 months. For the purpose of estimating costs, an estimate of 40 hearing days has been used.

(iii) Steps to be taken if Council wishes a Section 100 Public Inquiry

Should Council decide that it wishes to proceed with a section 100 public inquiry, instructions should be provided to staff to draft the requesting resolution to form the terms of reference for the inquiry. The terms of reference will need to be sufficiently particular to guide the inquiry and notify potential parties of the subject matter of the inquiry. Council will therefore have to give direction on the scope of any inquiry. Upon receipt of instructions, staff will also contact the Chief Justice of the Superior Court to determine the availability of an inquiry judge. A draft requesting resolution would then be brought back for passage by Council.

Conclusions:

(1) Based on the examination of options for investigation and inquiry as detailed in this report, Council realistically has the option of either awaiting the completion of the City's internal investigations to determine any future action or proceeding with an inquiry under section 100 of the Municipal Act;

(2) If Council wishes to proceed with a section 100 public inquiry, the requesting resolution to an inquiry judge must be carefully crafted as it constitutes the terms of reference or mandate binding the inquiry judge as well as notification of the subject matter to potential parties;

(3) It is difficult to estimate the costs of any inquiry in advance but a range of $1 million to $2 million (and more likely closer to $1 million) can be expected for an inquiry relating only to the MFP transactions that are currently the subject of the settlement discussions before Council. The basis for this estimate is set out in Appendix B to this report; and

(4) On the issue of the time-line of any inquiry, it is estimated that the time from the passage of the requesting resolution to the submission of a report would be approximately 9 to 12 months.

Contact:

James Anderson, Director, Municipal Law
Telephone: 392-8059; Fax: 397-5624
janders1@city.toronto.on.ca

APPENDIX A

Various Statutory Provisions relating to Municipal or Provincial Investigations or Inquiries

MUNICIPAL AFFAIRS ACT- PROVINCIAL MUNICIPAL AUDITS

Provincial municipal audit -- s. 9(1)

9.(1) The Ministry, upon its own initiative or whenever requested by any municipality expressed by resolution of its council, or on a petition in writing signed by not less than fifty ratepayers assessed as owners and resident in a municipality, may direct a provincial municipal audit of the financial affairs of the municipality.

Extent of audit -- s. 9(2)

9.(2) Any direction given by the Ministry may extend to an audit of all the financial affairs of a municipality or may be limited to the financial affairs of any local board thereof, or to any specified phase of such financial affairs or to any specified books, accounts, registers, records, vouchers, receipts, funds, money or financial transactions, kept by or under the charge of any officer of the municipality designated by the Ministry.
R.S.O. 1980, c. 303, s. 9.

General inquiry -- s. 10
History

10. The Ministry upon its own initiative may make an inquiry into any of the affairs of a municipality. R.S.O. 1980, c. 303, s. 10; 1993, c. 27, Sch.

Appointment of auditor -- s. 11

11. An audit directed to be made under this Part may be made by any officer of the Ministry, or by a competent auditor appointed by the Minister, and the officer and person so appointed for the purposes of such audit have all the powers mentioned in section 12. R.S.O. 1980, c. 303, s. 11.

Powers of auditor -- s. 12

12. For the purposes of any audit, the officer of the Ministry or other person appointed to make the audit may require the production of all or any books, records and documents that may in any way relate to the affairs of the municipality that are the subject of the audit, and inspect, examine and audit and copy them, and may require any officer of the municipality and any other person to appear before him or her and give evidence on oath touching any of such affairs, and for such purpose has all the powers of a commission under Part II of the Public Inquiries Act, which Part applies to such audit as if it were an inquiry under that Act. R.S.O. 1980, c. 303, s. 12.

Report on audit -- s. 13

13. Upon completion of an audit under this Part, the auditor shall report thereon in writing to the Deputy Minister, who shall forthwith transmit a copy of the report to the municipality. R.S.O. 1980, c. 303, s. 13.

Powers of Ministry as a result of an audit or inquiry -- s. 14

14. The Ministry, as a result of an audit of the affairs of a municipality made under this Part, or as a result of an investigation or inquiry made under any general or special Act, may make such orders as it sees fit requiring the municipality to carry out, put into effect, observe, perform or enforce such matters or things as the audit, investigation or inquiry has disclosed as being necessary or desirable in the interests of the municipality or with respect to the due accounting for, collection or payment of any of its assets, liabilities, revenues, expenditures, funds or money or otherwise in any respect as the order of the Ministry may provide. R.S.O. 1980, c. 303, s. 14.

Fees for audit -- s. 15

15. The Ministry may fix the fees and allowances for expenses payable with respect to any audit of the affairs of a municipality under this Part, and the amount so fixed shall forthwith be paid by the municipality. R.S.O. 1980, c. 303, s. 15.

ONTARIO MUNICIPAL BOARD ACT

General municipal jurisdiction of the Board: -- s. 54(1)

54.(1) The Board has jurisdiction and power in relation to municipal affairs,

(i) to inquire at any time into any or all of the affairs, financial and otherwise, of a municipality and hold such hearings and make such investigations in respect thereof as may appear necessary or expedient to be made in the interest of the municipality, its rate-payers, inhabitants and creditors and particularly to make and hold such inquiries, hearings and investigations for the purpose of avoiding any default or recurrence of a default by any municipality in meeting its obligations;

PUBLIC INQUIRIES ACT

Appointment of commission -- s. 2

2. *Whenever the Lieutenant Governor in Council considers it expedient to cause inquiry to be made concerning any matter connected with or affecting the good government of Ontario or the conduct of any part of the public business thereof or of the administration of justice therein or that the Lieutenant Governor in Council declares to be a matter of public concern and the inquiry is not regulated by any special law, the Lieutenant Governor in Council may, by commission, appoint one or more persons to conduct the inquiry. R.S.O. 1980, c. 411, s. 2.*

APPENDIX B

Detailed Estimates of the Costs of a Section 100 Public Inquiry

The City's Obligation to Pay

The City pays the inquiry judge's expenses of the inquiry, i.e., the engagement of inquiry counsel, assistants, investigators, or other expenses that the inquiry judge considers advisable for the proper conduct of the inquiry.

Assumptions

The estimate of cost is based on the assumption that the Sarnia Inquiry forms a reasonable costing and timing model for the section 100 public inquiry. First, the transactional nature of the subject matter of the Sarnia inquiry is more similar to the subject matter here (i.e., the MFP leases) than the broader public interest inquiry of the Walkerton inquiry. The Risdon Inquiry in the 1970's (dealing as it did with allegations of misconduct by the chief plumbing inspector) interestingly had approximately the same time line and number of hearing days as the Sarnia inquiry. Sarnia's hearing stage was relatively recent (1998) and therefore the costing of the inquiry can be reasonably applied.

The cost of the City's own legal representation has not been included. The estimate does not take into account any funding to be provided to parties or employees for the costs of representation at the inquiry.

Commission Counsel

The total legal fees incurred by the City of Sarnia (for the reimbursement of commission counsel) in the Sarnia Public Inquiry (and aside from the legal fees for the various court challenges) were approximately $455,000. Some of this amount comprised duplication as a result of the need to restart the inquiry given the court challenges.

There are typically two parts to any inquiry: an investigative stage and a hearing stage. The hearing stage of the Sarnia Inquiry was fairly recent, the hearing taking place in 1998 after a delay of approximately 5 years as a result of the court challenges. The legal fees for the work in 1998 comprised approximately $290,000, which would have involved the actual hearing (33 hearing days) as well as the hearing preparation and legal review of the inquiry report.

One approach on an estimate of costs for the role of commission counsel is to determine a per hearing day cost which would include preparation and follow-up. In the Sarnia case, the per hearing day cost (using 1998 amounts only) was approximately $8,800. Assuming a 20% increase in costs and applying therefore a per hearing day cost of approximately $10,500, an MFP hearing estimated at 40 hearing days (approximately 2 months) would cost approximately $425,000 in fees for commission counsel.

The legal fees for commission counsel's involvement in the investigative stage for any MFP inquiry has been estimated at $250,000. This is an amount more than the prior years' counsel fees involved in the Sarnia inquiry and, arguably, is generous as commission counsel in this case would be able to take advantage of the investigative work by the City to date.

The total estimate for commission counsel by this approach is therefore $675,000.

This estimate compares favourably to an hourly approach based on the following hours at a combined hourly rate of $800.00/hr for senior and junior commission counsel:

- *10 hours a day for each of 40 hearing days,*
- *50 hours for preparation of the inquiry report,*
- *200 hours involved in preparation, and*
- *200 hours for investigation,*

for a total of $665,000.

<u>Investigator</u>

Sarnia spent approximately $60,000 for an investigator. In this case, KPMG has done most of the investigative work and document production and that work could be relied on for some savings. It is therefore estimated that any follow-up investigative work should not exceed $75,000.

<u>Advertising & Process</u>

In Sarnia, the cost was approximately $5,000. We have simply estimated based on multiplying the cost, namely to $30,000 given the cost of advertising in Toronto.

<u>Clerking Services</u>

The Inquiry Judge will need a clerk for the hearing. We have simply ascribed an amount of $15,000.

<u>Court Reporter</u>

Transcripts of the hearing will be required, typically daily. In the Sarnia case, that amount was approximately $42,000. In this case, the estimate is based simply on a little more than doubling, i.e., approximately $100,000.

<u>Inquiry Judge Incidental Expenses</u>

We have simply ascribed an amount of $5,000 for incidental expenses.

<u>Inquiry Hearing Room</u>

We assume a City facility can be used. If not, an amount of $20,000 has been used.

The total for all of the above is approximately $920,000. Applying a contingency of 15%, the cost would just exceed $1,000,000 subject, as set out above, to additional costs based on determinations to be made on the City's own legal representation and funding of parties.

*(Report dated January 28, 2002, addressed
to the Audit Committee, from the City Auditor)*

<u>Purpose</u>:

To respond to the request of City Council in connection with the review of various lease transactions that the City Auditor be requested to "continue to investigate and report to the Audit Committee on:

- *purchase or lease of Council orginal equipment (IT) and the whereabouts of this equipment;*
- *whether the City had been reimbursed for this equipment;*
- *whether proper approvals for the actions were received; and*
- *details surrounding the acquisition of this equipment by the Toronto Transition Team, such as the minutes of meetings, the bid process, bid proposals, the authorization of the Purchase Orders, the signatures on the contract and the interest rates on this contract or contracts."*

<u>Financial Implications and Impact Statement</u>:

There are no financial implications in relation to this report.

<u>Recommendations</u>:

It is recommended that the Chief Financial Officer and Treasurer, in consultation with the Commissioner of Corporate Services ensure that the Corporate financial manual currently being developed by the Finance Department include the following requirements;

(a) for all lease transactions a comprehensive financial analysis be prepared justifying the decision to lease;

(b) for all expiring lease agreements, a detailed financial analysis be prepared justifying the decision to either retain such equipment, extend the lease, or exercise any purchase option;

(c) for any lease agreements which may be renegotiated during its term, a detailed analysis be conducted outlining the financial implications of the renegotiation; and

(d) all such financial analyses be subject to appropriate supervisory review.

Background:

During its meeting of December 4, 5 and 6, 2001, City Council considered a number of reports in relation to the review of various computer-leasing contracts between the City of Toronto and MFP Financial Services. As a result of Council's consideration of these reports, the City Auditor was requested to:

"Continue to investigate and report to the Audit Committee on:

(a) purchase or lease of Council original equipment (IT) and the whereabouts of this equipment;

(b) whether the City had been reimbursed for this equipment;

(c) whether proper approvals for the actions were received; and

(d) details surrounding the acquisition of this equipment by the Toronto Transition Team, such as the minutes of meetings, the bid process, bid proposals, the authorization of the Purchase Orders, the signatures on the contract and the interest rates on this contract or contracts."

In conducting this review, the City Auditor has discussed this issue with:

- *Senior staff from the City Finance Department, including the Purchasing Division;*
- *Senior staff from the Information & Technology Division of the Corporate Services Department;*
- *The former Chief Administrative Officer;*
- *The former City Clerk;*
- *The former Commissioner of Corporate Services; and*
- *Various members of the Toronto Transition Team including the Chairman.*

In addition, as part of the continuing investigation of matters relating to other lease agreements with MFP, the firm of KPMG conducted further interviews with the former Chief Financial Officer and Treasurer and the former Executive Director of Information & Technology Division. Included in these interviews were discussions in connection with the lease agreements relating to Councillors computer equipment signed in late 1997. The City Auditor has reviewed the transcripts of these interviews. It should be added that both the former Chief Financial Officer and Treasurer and the former Executive Director of Information & Technology Division have been co-operative during this review.

The City Auditor has also reviewed various files and documentation made available to him during the course of this review.

We have not had discussions with representatives from MFP. Through their legal advisors they have informed us that, due to outstanding litigation proceedings brought against the City by MFP, they are not prepared to provide us with any information.

Comments:

On December 30, 1997, the City and MFP entered into a Master Equipment Lease Agreement numbered "784". The City's then Chief Financial Officer and Treasurer signed this agreement. This lease provided computer equipment for the newly elected City Councillors Offices. In regard to this particular equipment, the City and MFP entered into six equipment schedules under Master Lease 784 for assets with a total capital cost of approximately $1.1 million summarized as follows:

Equipment Schedule	*Effective Date*	*Term*	*Capital Cost of Assets $*
784-1	*January 1, 1998*	*3 years*	*991,430*
784-2	*June 1, 1998*	*2 years, 7 month*	*17,943*
PA1-1	*October 1, 1998*	*3 years*	*37,684*
PA1-2	*January 1, 1999*	*3 years*	*37,162*
PA1-3	*April 1, 1999*	*3 years*	*2,864*
PA1-4	*July 1, 1999*	*3 years*	*6,648*
			1,093,731

The $991,430 represented the major acquisition of computer equipment, while the balance of the expenditures represented minor computer and computer related accessories acquired subsequent to that date.

Equipment schedule 784-1 provided for annual lease payments of $336,000 including tax, each payable annually in advance commencing on January 1, 1998. In addition, based on a letter dated January 20, 1998 to the former Executive Director of Information & Technology from the Regional Marketing Manager of MFP, "It is agreed that upon lease termination of this Schedule and with the required written notification, City of Toronto has the option to purchase the equipment on this Schedule for the then Fair Market Value. The City of Toronto also has the option to extend the lease for a mutually agreeable term based on Fair Market Value if the Purchase Option is not exercised."

Equipment Schedule number 784-1 was authorized by the Chief Financial Officer and Treasurer and equipment schedules PA1-3 and PA1-4 were authorized by the Executive Director of Information & Technology. Both of these individuals were authorized to execute agreements on behalf of the City. The remaining equipment schedules were signed by City staff who were not authorized to do so.

In a memo dated April 21, 1998, the former Commissioner of Corporate Services indicated that "Due to budgeting constraints, please note that all future expenditures concerning the purchase of computer and related equipment and the hiring of staff must be approved by myself or the Interim Lead, Information & Technology Services Division, Jim Andrews."

The above capital cost of $1,093,731 does not represent the full costs incurred on computer equipment for the Councillors at that time. We have located invoices for other equipment, including servers and various software licenses of approximately $405,000 which were ordered in late 1997 and delivered in early 1998.

Approvals for the Acquisition of the Computer Equipment

We have not been able to locate documentation in regard to the approval process for the acquisition of the computer equipment for Council members in December 1997.

We have had discussions with two members of the Transition Team who indicated that there were no formal written approvals in connection with the acquisition.

We did, however, locate a briefing note prepared by the former Chief Administrative Officer dated January 14, 1998 addressed to Members of Council entitled "Councillor's Office Computers" (Appendix 1).

We have confirmed with the City Clerk's Office that this briefing note is not a part of the public record. The former Chief Administrative Officer also indicates that he does not recollect as to whether or not this briefing note was actually sent to Council members.

The briefing note was presumably prepared in response to two newspaper articles which appeared in the Toronto Star on January 10, 1998 and January 13, 1998. In this particular briefing note, which was prepared in a question and answer format, the following question was asked:

"How was the decision to update Councillors computer equipment made?"

The question was answered as follows:

- *"The Information Technology Service Review Team and the Council End Users Support Team jointly worked on a proposal to standardize the technology required to service the new City of Toronto Councillors and their offices.*
- *Several meetings were held between the Information Technology Service Review Team and the Transition Team outlining the need to upgrade technology. On November 26, 1997, Mr. Gee representing the Transition Team, requested a meeting to further discuss the Councillors proposed computer requirements. At that meeting, attended by Mr. J. Andrew and Mr. R. Walton, Mr Gee indicated that he was supportive of the initiative and he would recommend approval to the Transition Team. At this point, staff assumed the project would be approved.*
- *The Interim Implementation Task Force was advised of the urgency with this project in order to get Council up and running as soon as possible in the new year. A member of IITF asked staff to proceed with the arrangements. After the verbal approval was received from the Metro Commissioner of Corporate Services, purchase orders were signed by the Chief Financial Officer and Treasurer and executed on December 20, 1997."*

A further question was asked: "Were Councillors for the new City made aware of this decision?"

The question was answered as follows:

- *"Yes. A general meeting was held by the Clerk's Department on December 16 for all Councillors elect and staff. The new proposed technology was demonstrated at this time."*

Finally, the following question was asked in connection with the financing of the equipment:

"How will the new equipment be financed?"

- *"It was always the belief that this acquisition was considered a transitional cost and would be funded by the Province. Application will have to be made to the Province. However, a back-up plan was considered for the City to pay the cost until the Province considered the application. A three-year lease option with the annual payment of $325,000 was prepared with a termination clause included after one year."*

The briefing note, however, does not refer to the additional costs of $405,000 in relation to the acquisition. These costs were financed out of the City's operating funds.

We have had discussions with various staff who have indicated that no application was made to the Province for the financing of this equipment. We have not been able to ascertain the reason for this oversight.

Based on our review, there does not appear to have been a formal documented approval process by City Council or the Transition Team in connection with the acquisition of the computers. However, in view of the briefing note provided by the former Chief Administrative Officer, Council was likely aware of the process in regard to the acquisition and, presumably if it was viewed as inappropriate, concerns could have been raised at that time. We are not aware that any such concerns were raised.

The Procurement Process

An internal memorandum prepared and signed by the former Chief Financial Officer and Treasurer dated December 20, 1997, addressed to City Purchasing relating to the acquisition of computers indicated that:

- *"The acquisitions are being made through the existing vendors of record, SHL and Compugen Ltd. It is the intent to lease the software and desktop computers. The vendors will be providing leasing quotation, as part of their invoicing. The equipment being supplied from Charon Systems is because the current vendors of record are unable to deliver this server technology in time to meet the install schedule. Compaq Canada advise that Charon Systems is the only supplier in the area with the required technology in stock to fulfil this requirement."*

We have located two purchase requisitions, both dated December 18, 1998, to Compugen and SHL for estimated amounts of $389,836 and $567,221 respectively. The former Chief Financial Officer and Treasurer authorized both of these purchase requisitions. There are references on one of the purchase requisitions to the MFP leasing arrangement indicating that "invoice will come from MFP", "orders through MFP will be less than lease" and "MFP Technology Leased".

Two purchase orders were issued by the former Municipality of Metropolitan Toronto dated December 30, 1997, addressed to MFP. The equipment details on the purchase order agree to the equipment listed to the schedule attached to Equipment Schedule 784-1. Similarly, the lease payments indicated on the purchase orders agree to the lease payments in Equipment Schedule 784-1.

Based on our review, it appears that the purchase of the equipment was made by MFP and then the equipment was leased to the City by them. This transaction was not the subject of a sales leaseback agreement as had been the case in a number of subsequent lease arrangements with MFP. We have confirmed this with staff from the Information & Technology Division.

The Decision to Lease

We have not been able to locate any documentation supporting the business case to lease. There does not appear to be an analysis of the merits of leasing equipment compared to the purchase of such equipment, nor have we been able to locate any analysis to determine whether or not the rates being changed by MFP were commercially reasonable. Presumably, the decision to lease was based on initial cash flow considerations at the new City, although interim financing could have been obtained from other sources until Council approved the acquisition of the equipment in January 1998.

The lease rates charged by MFP were 6.25 percent. We have been advised by an external leasing expert, that at the time, this rate was commercially reasonable.

The Selection of MFP as the Lessor

Based on discussions and interviews with the former Executive Director of Information & Technology, we were informed that the "784" lease was apparently the subject of an RFQ process. However, our discussions with the City Purchasing Department indicate that they have not been able to locate any documentation related to the RFQ (e.g., the RFQ itself, the RFQ responses or the evaluation of the RFQ have not been located, nor do they have any recollection that such a process took place).

The former Chief Financial Officer and Treasurer, in her memo dated December 20, 1997, indicated that the vendors would be providing leasing quotations as part of their invoicing. We have not been able to locate documents indicating this to be the case. We have also attempted to obtain confirmation of this information from both SHL and Compugen but have not been successful in doing so.

During our review of documentation attached to the purchase orders submitted to MFP, we did find handwritten details of lease rates indicated as having been provided by MFP. The lease rates quoted are the same as the lease payments contractually agreed to and actually made to MFP. The Purchasing and Materials Management Division has indicated to us that competitive lease quotes were obtained by telephone from the suppliers of the equipment, Compugen and SHL and others including MFP. Telephone quotes were obtained because of the time constraint in getting the equipment in place by the time that it was required. Documentation supporting this has not been located. Purchasing and Materials Management Division has explained that, as a result of staff moves and file relocations during the amalgamation, the telephone quote files for the buying group who processed this purchase cannot be located. However, the former Buyer who processed this purchase is still with the Division and has indicated that he did, in fact, obtain competitive telephone quotes and that the order was issued to the company providing the best leasing rates.

Interviews with the former Chief Financial Officer and Treasurer conducted by KPMG in regard to this matter indicates that the former Chief Financial Officer and Treasurer:

(a) was not aware of any RFQ process which took place at that time;

(b) was not aware that the computer acquisitions in January 1998 were the subject of a lease agreement and, consequently, would not have been aware that MFP were the lessors of this equipment; and

(c) was not aware of the existence of MFP prior to 1999.

Based on the information we have been able to obtain, written records of the competitive process in the selection of MFP have not been located. The only indication that a competitive process took place is the assurance from the information provided by the former staff member who processed this purchase who has informed us that he did, in fact, solicit telephone quotes to obtain the best leasing rates for the equipment.

<u>The Financing of the Computer Acquisitions</u>

As indicated previously, it was anticipated that the Province would finance the computer acquisitions. Based on our review, an application to the Province for specific funding does not appear to have been made. In actual fact, other than the briefing note from the former Chief Administrative Officer in January 1998, no further information exists in relation to the possibility of provincial financing.

Funding for the computer acquisitions was required as follows:

Year	*Lease Costs*	*Other Costs*	*Total*
1998	*325,000*	*405,000*	*730,000*
1999	*325,000*	*-*	*325,000*
2000	*325,000*	*-*	*325,000*

The lease costs were charged to a non-program corporate account while the other costs were charged to an account called "transitional amalgamation costs – finance". Both of these accounts were operating accounts.

The Disposal of the Equipment at the end of the Lease

At the conclusion of the lease, the equipment originally leased from MFP in December 1997 was returned to them. The majority of this equipment was returned on January 2001. In a number of cases, certain computer equipment was retained by a number of Councillors and was purchased by them from MFP.

It appears as if the decision to return the equipment at the end of the lease was made with little financial analysis nor with any input from Council members and their staff. In view of the lack of substantive software developments over the past number of years, it may have been more financially prudent to purchase the equipment at the end of the lease for its fair market value or extend the lease for a further period. In addition, it may also have been appropriate to replace only certain equipment in each Councillors office rather than conducting a full scale "refresh" of all equipment. However, no financial analysis was done to determine which alternative were appropriate.

The Acquisition of New Equipment in 2001

On January 1, 2001, a new lease schedule 838-10 was approved, which was signed by the Director of Capital Projects in the Information & Technology Division. This lease was for a three-year term with an interest rate of 7.05 percent. We have been advised by an external leasing expert that this rate is commercially reasonable. The total capital cost of this equipment was $720,908. The authority for this particular transaction was presumed to be the authority provided by the City Council to use MFP as the lessor of record.

We have confirmed with City Legal who have indicated that the Director of Capital Projects was not authorized to sign this agreement. The Director was aware in early 2000 that she did not have the authority to sign this agreement but did so an any event. We have been advised by her, via her interviews with KPMG, that she believed she was the first signatory to the document and not the sole signatory.

The Authority to Commit the City

By way of background, the Master Lease Agreement signed by the City in July 1998 provided that MFP could request that the City provide: "such certified resolutions and opinions from (the City's) counsel.…to the effect that (the lease agreements have) been duly authorized by all necessary corporate action, and that the person(s) executing said documents are duly authorized to do so and that all such documents constitute legal, valid and binding agreements of the (City) and are enforceable in accordance with these terms."

In early 2000, MFP requested that such an opinion be provided by the City in respect of agreements then executed in respect of the 838 lease. In reviewing this issue, the City Solicitor's office found that some of the Equipment Schedules had been signed by the Director, Capital Projects for Y2K, who did not have the authority to sign the Agreements. As a result, certain of the Equipment Schedules were re-executed by the Chief Financial Officer and Treasurer.

On March 15, 2000, the City Solicitor issued a letter to MFP indicating that the agreements had been duly authorized by the City, the persons executing the agreements were authorized to do so, and the agreements were legal, valid and binding agreements of the City.

Subsequent, to this date lease schedule 838-10 was approved, as well as two other leases.

Each one of these leases were approved by the Director of Capital Projects even though she was informed in early 2000 that she did not have the authority to execute the agreements on behalf of the City. It is reasonable to assume, based on the re-execution of the previous agreements and the subsequent legal letter from the City Solicitor, that MFP would have been aware of this particular fact as well.

This information has been forwarded to both City Legal and outside Counsel for their consideration and review.

Conclusions:

Computer equipment of $991,430 acquired for Councillors on approximately January 1, 1998, was leased from MFP Financial Services Ltd. for a three-year term. Further equipment in the amount of approximately $405,000 was purchased in January 1998 and funded directly by the City. Additional equipment totalling $102,301 was acquired at various times during 1998 and 1999 and leased from MFP. We have located documentation indicating that the acquisition of the computers was an amalgamation cost and, as such, it should have been recovered from the Province. No application for the recovery of the funds was made.

We have not been able to determine whether the procurement of the equipment was approved nor is there documentation confirming that a competitive process was followed in regard to the selection of MFP as the successful lessor. We have been advised, however, by staff in the Purchasing and Materials Management Division that such a process did, in fact, take place.

A business case relating to the decision to lease was not prepared nor was there any analysis prepared in relation to the financial viability of returning equipment at the conclusion of the lease, extending the lease or exercising a purchase option.

Contact:

Jeffrey Griffiths, City Auditor, Tel: (416) 392-8461, Fax: (416) 392-3754
E-Mail: Jeff.GRIFFITHS@city.toronto.on.ca

List of Attachment:

Appendix 1 – Briefing Note, Councillors' Office Computers, January 14, 1998)

(A copy of the briefing note, referred to in the foregoing report dated January 28, 2002, is on file in the office of the City Clerk.)

(City Council also had before it, during consideration of the foregoing Clause, the following report (February 12, 2002) from the City Auditor:

Purpose:

To respond to the request of the Audit Committee that the City Auditor, in consultation with the Chief Administrative Officer and external counsel, develop recommended Terms of Reference for a public inquiry in respect of the MFP contracts and related matters.

Financial Implications and Impact Statement:

The financial implications in relation to a public inquiry have been reported separately.

Recommendation:

It is recommended that, should Council wish to proceed with a public inquiry, the attached draft resolution provided by external counsel and incorporating the recommended Terms of Reference be passed.

Background:

The Audit Committee, at its meeting of February 8, 2002,

(1) recommended to City Council that:

(a) the City Auditor, in consultation with the Chief Administrative Officer and external counsel, develop recommended Terms of Reference for a public inquiry in respect of the MFP contracts and related matters;

(b) the external counsel provide to City Council, at its meeting to be held commencing February 13, 2002 a draft resolution for its consideration which would allow for commencement of an inquiry under section 100 of the Municipal Act; and

(2) instructed the City Auditor to immediately advise all Members of Council of Recommendation No. (1) above and that any submissions made to the City Auditor, the Chief Administrative Officer and external counsel by any Member of Council with respect to the Terms of Reference must be in writing.

Comments:

Consultations have been conducted with the Chief Administrative Officer and external counsel in regard to the preparation of the attached recommended Terms of Reference. Members of Council were contacted and instructed to provide me with written suggestions in relation to the Terms of Reference. The recommended Terms of Reference for a public inquiry were incorporated directly by external counsel into the attached draft resolution which would be required to be passed under the provisions of section 100 of the Municipal Act.

Conclusions:

Should Council wish to proceed with a public inquiry, the attached draft resolution provided by external counsel and incorporating the recommended Terms of Reference should be passed.

Contact:

Jeffrey Griffiths, City Auditor, Tel: (416) 392-8461, Fax: (416) 392-3754
E-Mail: Jeff.GRIFFITHS@city.toronto.on.ca

Attachment

Terms of Reference – Public Inquiry in Respect of the MFP Contracts

Being a Resolution to Request a Judicial Inquiry Pursuant to Section 100 of the Municipal Act and to Provide the Terms of Reference Therefor

WHEREAS, under section 100 of the Municipal Act, R.S.O. 1990 c. M.45, a Council of a municipality may, by resolution, request a Judge of the Ontario Court (General Division), now the Superior Court of Justice, to inquire into or concerning any matter connected with the good government of the municipality, or the conduct of any part of its public business; and

WHEREAS any Judge so requested shall make inquiry and shall report with all convenient speed, to Council, the result of the inquiry and the evidence taken, and for that purpose shall have all the powers of a commission under Part II of the Public Inquiries Act, R.S.O. 1990 ch. P. 41; and

WHEREAS on approximately January 1, 1998, computer equipment acquired for the newly elected City Councillors' offices was leased from MFP Financial Services Ltd. ("MFP") for a three year term pursuant to a Master Equipment Lease Agreement numbered "784" and subsequently by equipment schedules under the Master Agreement for assets totaling approximately $1,093,731; and

WHEREAS there is no written documentation that the procurement of the equipment was lawfully approved or that a competitive process was followed in awarding the leasing contract to MFP; and

WHEREAS in early 1999 staff were exploring financing options for the large-scale software and computer acquisitions anticipated as necessary to deal with what is commonly referred to as the "Y2K problem" and a Request for Quotations ("RFQ") was issued in May 1999 to solicit bids for computer leasing; and

WHEREAS pursuant to a report from the City's then Chief Financial Officer and the City's then Executive Director, Information Technology, Council approval was obtained to lease $43 million of computer and related equipment by the adoption of Clause No. 11 of Report No. 4 of the Policy and Finance Committee at Council's meeting of July 27, 28, 29 and 30, 1999; and

WHEREAS the report indicated to Council that the bid by MFP was the preferred bid and Council authorized the City of Toronto to enter into a leasing contract with MFP for three years; and

WHEREAS the report to Council failed to mention that the rates quoted in the responses to the RFQ were only in effect for 90 days and staff entered into a Master Equipment Lease Agreement and a Program Agreement after the 90 day period expired, which agreements contemplated various Equipment Schedules to the Master Equipment Lease Agreement that would identify the equipment to be leased and lease terms and rates in respect of the equipment; and

WHEREAS in the fall of 1999, staff initiated a sale and lease back transaction with MFP of the City's computer equipment which had been bought prior to the Council authority of July 1999 and there was no mention of a sale and lease back to be bid on in the RFQ and no authorization of a sale and lease back was sought in the report to Council; and

WHEREAS, through the execution by staff of Equipment Schedules, the City has leased up to $85 million of computer equipment although the Council approval indicated an estimated cost of acquisition of $43 million of equipment; and

WHEREAS with two exceptions, the initial Equipment Schedules were not for three years as approved by Council, but were for longer terms, most commonly five years and in the summer of 2000 a number of the equipment leases were restructured to extend the term of some of the Equipment Schedules beyond even the five year period; and

WHEREAS the report to Council indicated that the preferred bid by MFP contained an implicit interest rate of 4.6% and the Equipment Schedules executed by City staff contained lease rates with implicit interest rates significantly in excess of the 4.6% interest rate; and

WHEREAS in or about December 1999, the City's Director of the Y2K Project recommended the acquisition by the City of 10,000 Oracle Database enterprise software licences, the acquisition was approved by the City's then Y2K Steering Committee, with subsequent approval by the City's then Chief Administrative Officer, and the 10,000 licences were then acquired by lease through MFP by the addition of an Equipment Schedule to MFP's Master Equipment Lease Agreement; and

WHEREAS the acquisition of the 10,000 Oracle licences was a serious miscalculation and it is unclear as to whether such acquisition was co-ordinated with the City's agencies boards and commissions, why leasing was undertaken as opposed to the continued purchase of the licences directly from Oracle and how MFP was selected for leasing of the Oracle software; and

WHEREAS the concerns of the City in respect of the MFP and Oracle transactions are more fully detailed in the attached reports from the Chief Administrative Officer and City Auditor, dated respectively in respect of the MFP transactions and the Oracle transaction, November 29, 2001 and February 6, 2002 and in respect of the 1998 computer lease numbered "784", the report from the City Auditor, dated January 28, 2002; and

WHEREAS the public inquiry would permit (i) the Commissioner to investigate the existence of any malfeasance, breach of trust or misconduct, (ii) the Commissioner to make recommendations that would be a benefit for the future conduct of the public business of the City, and (iii) the public to understand and evaluate fully the above noted transactions;

NOW THEREFORE the Council of the City of Toronto does hereby resolve that:

(1) an inquiry is hereby requested to be conducted pursuant to section 100 of the Municipal Act which authorizes the Commissioner to inquire into, or concerning, any matter related to a supposed malfeasance, breach of trust or other misconduct on the part of a member of council, or an officer or employee of the City or of any person having a contract with it, in regard to the duties or obligations of the member, officer, or other person to the corporation or to any matter connected with the good government of the municipality, or the conduct of any part of its public business, and

(2) the Honourable Chief Justice Lesage, Chief Justice of the Superior Court of Ontario, be requested to designate a judge of the Superior Court of Ontario as Commissioner for the inquiry and the judge so designated is hereby authorized to conduct the inquiry.

AND IT IS FURTHER RESOLVED THAT the terms of reference of the inquiry shall be:

To inquire into all aspects of the above transactions, their history and their impact on the ratepayers of the City of Toronto as they relate to the good government of the municipality, or the conduct of its public business, and to make any recommendations which the Commissioner may deem appropriate and in the public interest as a result of his inquiry.

AND IT IS FURTHER RESOLVED THAT the Commissioner, in conducting the inquiry into the transactions in question to which the City of Toronto is a party, is empowered to ask any questions which he may consider as necessarily incidental or ancillary to a complete understanding of these transactions;

and, for the purpose of providing fair notice to those individuals who may be required to attend and give evidence, without infringing on the Commissioner's discretion in conducting the inquiry in accordance with the terms of reference stated herein, it is anticipated that inquiry may include the following:

(1) an inquiry into all relevant circumstances pertaining to the various transactions referred to in this resolution, including the relevant facts pertaining to the various transactions at the relevant time as contained in the reports dated November 29, 2001, February 6, 2002 and January 28, 2002, the basis of and reasons for making the recommendations for entering into the subject transactions and the basis of the decisions taken in respect of the subject transactions;

(2) an inquiry into the relationships, if any, between the existing and former elected and administrative representatives of the City of Toronto and the existing and former principals and representatives of MFP and Oracle at all relevant times; and

(3) an inquiry into any professional advice obtained by the City of Toronto in connection with the subject transactions at the relevant times.)

(City Council again had before it, during consideration of the foregoing Clause, the following confidential report (December 20, 2001) from the Chief Administrative Officer, such report now public in its entirety:

Purpose:

The purpose of this report is to recommend approval of the Minutes of Settlement as recommended by external legal counsel and to advise Council on the public disclosure of the reports leading to the resolution of outstanding issues with MFP.

Financial Implications and Impact Statement:

N/A

Recommendations:

It is recommended that Council approve the Minutes of Settlement as recommended by the City's external counsel, Mr. Alan Lenczner, and upon approval of the Minutes of Settlement authorize the public release of the attached backgrounder, the backgrounder being in essence the contents of the prior in camera report, dated November 29, 2001, pertaining to the facts of the City's review of the MFP Financial Services computer leasing contract modified to delete any information pertaining to staff behavior which is the subject of ongoing investigation as directed by Council.

Background:

At its special meeting on December 20, 2001, Council will be considering a confidential report from external legal counsel on a proposed settlement with MFP Financial Services ("MFP").

Comments:

It is appropriate that upon approval of the Minutes of Settlement that the prior in camera report, dated November 29, 2001, setting out the facts contained in the City review of the computer leasing contract be publicly released subject only to the deletion of information which could pertain to staff behavior which is subject to ongoing investigation as directed by Council.

BACKGROUNDER

The following constitute the essential facts forming the background of the City's review of the MFP computer leasing contract as contained in an in camera report, dated November 29, 2001, from the City's Chief Administrative Officer and the City Auditor.

(a) Facts:

In May of 2001 the Chair of Audit Committee raised concerns that the City's contract with MFP exceeded the original intent and approvals of Council. Specifically, the Chair of Audit Committee argued that Council had not approved the use of MFP as a vendor of record beyond very specific Y2K related purchases.

In May of 2001, the Acting Executive Director of Information Technology initiated a review of the issues raised by the Chair of Audit committee.

On July 24th, 2001, City staff became aware of media reports about the City of Waterloo's contract with MFP Financial Services. The reports suggested that the City of Waterloo was initiating legal action against MFP in relation to alleged changes in the interest rates implicit in their contract. A report in front of Toronto City Council recommending MFP as the successful bidder in an RFP to lease City photocopiers was referred back to staff at the request of the acting CAO.

City Financial Planning staff undertook a preliminary review of the implicit effective interest rates arising from the City's contract with MFP. This initial analysis suggested that there had been increases in the effective interest rates. As well, the initial review revealed inconsistencies between the original Council approval and the current arrangements with MFP.

The acting CAO created a working group to undertake a thorough analysis. The working group included the Commissioner of Corporate Services, the City Solicitor, and the Acting Executive Director of Information Technology. In addition, the City Auditor was requested to participate in the review. City Council was informed by a memo from the Acting CAO that a review was underway and that the results would be reported out to the appropriate committee of Council.

It quickly became apparent that the City lacked the technical expertise to properly analyze the highly complex lease documents and schedules, particularly because the schedules to the lease had changed on a number of occasions. On the advice of the City Auditor, an external lease expert, Mr. Greg Dorbeck of Pivotal Technologies, was contracted to undertake an examination of the lease.

It was determined by the acting CAO that there were two key elements of the review; an analysis of the financial implications of the lease; and an analysis of staff decision making and management systems in place in relation to the lease. The Acting CAO engaged the services of KPMG and external legal advisors to ensure that the review was done in a strictly objective manner.

Throughout the review, weekly or semi-weekly meetings of the review team were held with the external experts. During the course of the review all available documents were collected, but it quickly became apparent that many of the key decision points related to the lease had little or no supporting documentation.

A series of meetings have been held with MFP, both to obtain documents relevant to the review, and to discuss some of the findings. It should be stated that MFP has been very helpful in agreeing to meet with the City and its external advisors and in providing documents and records.

There are a number of major areas of focus arising from the review.

RFQ and Report to Council

In early 1999 staff were exploring financing options for the large-scale computer acquisitions anticipated for Y2K. Leasing was recommended as an approach because it reduced the initial capital outlay and stabilized year to year payments and budgets. To this end, an RFQ was issued on May 31 of 1999 to solicit bids for computer leasing. Six companies bid on the RFQ.

The RFQ did not request an effective interest rate, only a payment rate quoted as an amount per $1,000 of purchase value. The rate to be quoted in bids was for the first 90 days only of a three-year lease (the rate quoted would apply to the duration of all leases entered into during the 90-day period). Respondents were also required to include in their submissions a description of the mechanism for setting the lease rates beyond the initial 90 days.

The contract with MFP was signed after the 90 day period expired. It is important to note that, consistent with the RFQ requirements, all respondents to the RFQ quoted rates that were only valid for 90 days and that all could have changed their rates after that period.

Five year initial lease term

The various contractual documents constituting the business arrangements with MFP are numerous and complex. The master contract with MFP was reviewed by outside legal 'as to form' only. Most of the equipment leased is included in a number of equipment schedules that are sub-documents of the master lease. In total, the City has entered into 15 equipment schedules with MFP, three of which have since been terminated and re-written.

With two exceptions, the initial leasing schedules were not for three years as approved by Council, but were for longer terms, most commonly five years. The extension of the lease term increased the total financial cost to the City over the term of the agreement.

In addition, when the initial lease was signed in October of 1999 for five years, the rate of interest implicit in the lease payments was significantly higher than the interest rate implicit in MFP's bid for the first 90 days and on which Council made its leasing decision. This also increased the City's total financial obligation. There is no evidence that any analysis was undertaken of the financial impact of extending the lease term or the new payment rate.

Sale Lease Back of previously purchased equipment

Between January 1999 and the signing of the first equipment schedules with MFP, the City purchased a large amount of computer equipment and software in preparation for Y2K. In the fall of 1999, staff initiated a sale and lease back transaction of this equipment with MFP. All of the previously purchased equipment was sold to MFP and leased back by the City. Additional equipment was purchased by the City and sold to MFP and leased back through 2000. In total, $23.5 million dollars of equipment was sold to MFP and subsequently leased back to the City.

There is no mention of a sale leaseback in the RFQ or the report to Council. In the opinion of the City Solicitor, the sale leaseback should have been explicitly approved by Council.

City staff failed to collect from the federal government a GST rebate due the City worth approximately $1.8 million. Staff are now attempting to recover the rebate.

Lease Restructuring of July 2000

In the summer of 2000 a number of the leases were restructured and, in the course of this restructuring, the term of some leases was extended beyond the initial five year period. The review indicates that there was an assumption that this was an administrative change only and had no financial impact.

During the restructuring, equipment was resorted into five new schedules. All printers were placed in one schedule, laptops in another, etc. As a result of this lease restructuring, the majority of the equipment in the restructured lease schedules now has a term of 5½ years. Some other equipment in the restructured lease schedules now has a term of either 5 years or 5¼ years.

This restructuring did have a financial impact. The total obligation of the City increased. Moreover, the restructuring failed to take into account payments that had already been made by the City on the equipment placed into the restructured lease. The payments which result in this additional cost to the City will arise at the end of the lease term (i.e., the final additional payments to be made 2005).

Total Amount Under Lease

Council approved the leasing of $43 million of computer equipment for three years at an effective interest rate for the initial 90 day period of approximately 4.6%. However, the City is currently leasing $80.5 million in assets from MFP. Virtually all computer equipment acquired by the City in 2000 and 2001 was leased from MFP. The review found that there was a pervasive belief across finance, purchasing and I&T staff that the MFP lease was to be used exclusively for computer leasing, and that this was appropriately approved.

The Council direction from July 1999 directed that the former Chief Financial Officer and former Executive Director of Information and Technology report back on future or additional leasing opportunities. There have been no subsequent reports.

(b) Financial Impact

The calculation of the financial impact to the City is complex because it is a factor of both lease rate changes, changes in the length of the lease term, and other factors. In addition the precise financial impact is contingent on the City making a decision, as yet unmade, on whether to buy out the computer equipment at the end of the lease. Moreover there are several possible baselines against which to measure the impact to the city.

Comparing the City's current obligation to the rate proposed in the original MFP lease is problematic. It was understood by MFP and city staff from the outset that the rates would change during the course of the lease and would not remain fixed at 4.6%. This fact was, however, not reported to Council. The Council report can therefore leave a reader with the erroneous impression that the initial rate would remain fixed for the duration of the lease term.

It is also important to note that the initial purchase/lease analysis was based on MFP's proposed lease rate with an implicit effective interest rate of 4.6%. At the current lease rate, the purchase/lease analysis may not hold.

There are possible future financial impacts for the City related to the lifespan of the equipment under lease. The current leases require that the City continue to pay for most of the City's computer infrastructure into 2005. While every attempt will be made to maximize the lifespan of the computer equipment purchased in 1999, some elements of that infrastructure do not have a five to six year lifespan. Some network devices, servers, storage devices (particularly those that operate 24 hours a day) typically have short lifespans and will have to be replaced or upgraded before 2005, in some cases in 2002-3. That means that the City will inevitably find itself in a position of continuing to pay for some equipment that has been replaced and disposed of.)

MINUTES OF SETTLEMENT

(Released in public on December 20, 2001.)

***WHEREAS** the City of Toronto (the "City") and MFP Financial Services Ltd. ("MFP") signed Master Equipment Lease Agreement No. 838 ("Master Lease") dated as of July 30, 1999; and*

***WHEREAS** the Master Lease was an umbrella agreement between MFP and the City which contemplated the execution of Equipment Schedules which would set out the equipment to be leased, the length of leases and the payment terms; and*

***WHEREAS** the City and MFP or Aztec Limited Partnership ("AZTEC") signed 15 Equipment Schedules pursuant to the Master Lease, three of which have been cancelled, which are set out hereto as Schedule "A" ("Leases"); and*

***WHEREAS** the City has raised several issues with respect to the Leases; and*

***WHEREAS** as of December 1, 2001, the City owes to MFP outstanding lease payments with respect to the Leases in the amount of $8,373,182.00 ("Open Receivables"); and*

***WHEREAS** the City is in possession of equipment purchased by MFP at the City's request and on its behalf with a capital value of $3,901,788.00 for which no leases have been executed ("Equipment Not Under Lease"); and*

***WHEREAS** the City is also in possession of equipment which MFP has ordered at the City's request an on its behalf, but which MFP has not paid for, with a capital value of $1,662,574.86, for which no leases have been executed ("Further Equipment"); and*

***WHEREAS** the City, MFP and AZTEC wish to resolve the issues between them in relation to the Leases without any admission of liability:*

IT IS HEREBY AGREED THAT*:*

(1) The City will forthwith pay MFP $9,054,970.00 in full satisfaction of the Open Receivables and for full and clear title to the Equipment Not Under Lease. For greater clarity, MFP agrees to waive $3,220,000.00 of the amount otherwise owing to it by the City.

(2) MFP will entirely waive any and all interest amounts owing to it as a result of the Open Receivables up to the date hereof.

(3) MFP represents and warrants that upon payment of the amount set out in Clause 1, MFP's assigns will be fully paid and satisfied with respect to the Leases as of the date hereof.

(4) The City will forthwith directly pay the owners/suppliers of the Further Equipment the full amount of $1,662,574.86 and, if so requested, any interest owing on that sum attributable to late payment of the purchase price, for full and clear title to the Further Equipment.

(5) As of December 31, 2004, Leases 838-5, 838-6, 838-7, 838-8, 838-9 will be deemed to have reached the Expiration Date within the meaning of Appendix "B" to the Leases, such that the End of Term terms and conditions shall then apply. For greater clarity, the City shall make the lease payments due on January 1, 2005 under the said Leases.

(6) The City shall execute and deliver to MFP and AZTEC a Release in the form attached hereto as Schedule "B".

(7) MFP and AZTEC shall execute and deliver to the City a Release in the form attached hereto as Schedule "C".

(8) MFP and the City will make a public statement in the form attached hereto as Schedule "D" ("Statement"). MFP and the City shall use their best efforts to ensure that they do not make any public statements inconsistent with the Statement.

(9) MFP agrees to cooperate with the City in the City's investigation into the processes by which the Leases were agreed upon. More particularly, MFP agrees to grant reasonable access to: (1) MFP's Chief Financial Officer, its Sales Representative Dash Domi and such other employees as the City may reasonably request for interviews by a representative of the City; and (2) MFP's financial records documenting entertainment expenses or benefits of any other form given by MFP to former or current City employees and/or councilors.

(10) MFP acknowledges that no other amounts are owed by the City pursuant to the Leases as of December 18, 2001.

(11) MFP consents to the public disclosure of the Master Lease and Leases.

(12) Except as expressly provided in these Minutes of Settlement, the City shall comply with the terms of the Leases.

IN WITNESS WHEREOF THESE MINUTES HAS BEEN SIGNED AND WITNESSED:

______________________	______________________
Date	*Harry Underwood* *Solicitors for MFP and AZTEC*
______________________	______________________
Date	*Alan J. Lenczner* *Solicitors for the City of Toronto*

SCHEDULE "A"

(1) Equipment Schedule No. 838-1 ("Lease 838-1") was executed with effect from October 1, 1999. The term was 60 months. The total value of the equipment under lease was $20,312,332.77.

(2) Equipment Schedule No. 838-3 ("Lease 383-3") was executed with effect from December 1, 1999. The term was 60 months. The total value of the equipment under lease was $8,268,344.00.

(3) Equipment Schedule No. 838-4 ("Lease 838-4") was executed with effect from December 1, 1999. The term was 36 months. The total value of the equipment under lease was $13,949,441.44.

(4) Equipment Schedule No. PA1-1 ("Lease PA1-1") was executed with effect from January 1, 2000. The term was 60 months. The total value of the equipment under lease was $6,148,124.76.

(5) Equipment Schedule No. 838-2 ("Lease 838-2") was executed with effect from February 1, 2000. The term was 59 months. The total value of the lease was $11,336,651.00.

(6) Equipment Schedule No. PA1-2 ("Lease PA1-2") was executed with effect from April 1, 2000. The term was 60 months. The total value of the equipment under lease was $5,638,196.71.

(7) Equipment Schedule No. PA1-3 ("Lease PA1-3") was executed with effect from October 1, 2000. The term was 60 months. The total value of the equipment under lease was $522,072.50.

(8) Equipment Schedule No. PA1-4 ("Lease PA1-4") was executed with effect from January 1, 2001. The term was 60 months. The total value of the equipment under lease was $9,123,213.82.

(9) Equipment Schedule No. 838-10 ("Lease 838-10") was executed with effect from January 1, 2001. The term was 36 months. The total value of the equipment under lease was $720,908.00.

(10) Equipment Schedule No. PA1-5 ("Lease PA1-5") was executed with effect from April 1, 2001. The term was 60 months. The total value of equipment under lease was $4,089,753.00.

(11) Effective as of July 1, 2000, Leases 838-1, PA1-1, and PA1-2 were cancelled and re-written into five new Equipment Schedules organized by equipment type as follows:

Equipment Schedule Number	*Type of Equipment*	*Capital Cost of Leased Equipment* **$**
838-5	*Desktop computers*	*18,797,529*
838-6	*Monitors*	*905,056*
838-7	*Notebook computers*	*2,496,421*
838-8	*Printers*	*974,160*
838-9	*Server and network*	*9,336,730*
Total		*32,509,896*

The terms were all 57 months.

SCHEDULE "B"

R E L E A S E

The undersigned CITY OF TORONTO (hereinafter called the "Releasor"), which term includes its agents, employees, administrators, successors and assigns, in consideration of the sum of $3,220,000.00 and other good and valuable consideration, the receipt of which is hereby acknowledged, hereby remises, releases and forever discharges MFP FINANCIAL SERVICES LTD., and AZTEC LIMITED PARTNERSHIP, and their respective officers, directors, agents, employees, partners, administrators, successors and assigns and any of them (collectively the "Releasees") from all actions, suits, debts, dues, accounts, bonds, covenants, contracts, damages, claims and demands whatsoever, and whether at the date hereof they are known or unknown, which the Releasor ever had, now has or which its heirs, executors, administrators or assigns, or any one of them, can, shall or may hereafter have for or by any cause, matter or thing whatsoever existing up to the present time and, without limiting the generality of the foregoing, the Releasor hereby specifically releases:

(a) any claims existing up to the present time arising out of any business transaction heretofore conducted between the Releasor and the Releasees or any of them including Master Equipment Lease Agreement No. 838 dated as of July 30, 1999 and all Equipment Schedules executed as of this date pursuant thereto (the "Leases");

(b) the claims set out in the Releasor's draft statement of claim appended to this release.

PROVIDED THAT the continuing obligations of the parties to the Leases, as set forth in the Leases, and as modified by the Minutes of Settlement, are not hereby released.

IT IS FURTHER AGREED AND UNDERSTOOD that the Releasees specifically include the assignees of the interest of MFP Financial Services Ltd. in the Leases, including The Canada Life Assurance Company and Clarica Life Insurance Company.

IT IS FURTHER AGREED AND UNDERSTOOD that the Releasees do not by the payment aforesaid or otherwise admit any liabilities or obligations whatsoever to the Releasor and such liabilities and obligations are, in fact, denied.

AND IT IS FURTHER AGREED AND UNDERSTOOD that for the consideration aforesaid the Releasor undertakes and agrees not to take any steps or initiate any proceedings against any person, partnership, corporation or other such entity which might be entitled to claim contribution, indemnity or other relief over against the Releasees. Except nothing in this Release shall preclude the City from taking any steps or initiating any proceedings against any former or current City employee or councillors, provided that the City shall indemnify the Releasees to the extent of any claims by such parties with respect to the Leases.

IN WITNESS WHEREOF the Releasor has executed this release and the signature of its officers duly authorized to do so this on this day of December, 2001.

CITY OF TORONTO
Per:

____
Per:

____

SCHEDULE "C"
FINAL RELEASE

IN CONSIDERATION OF *the payment by* ***THE CITY OF TORONTO****, (the "Releasee") to* ***MFP FINANCIAL SERVICES LTD. ("MFP") and AZTEC LIMITED PARTNERSHIP*** *(collectively the "Releasor") of the sum of Nine Million, Fifty Four Thousand, Nine Hundred and Seventy dollars, ($9,054,970.00), and other good and valuable consideration, the receipt whereof is hereby acknowledged, the Releasor hereby releases and forever discharges the Releasee, its successors and assigns from any and all actions, causes of action, suits, debts, dues, accounts, bonds, covenants, contracts, claims and demands whatsoever, which against the Releasee the said Releasor, its successors, administrators or assigns, or any of them ever had, now have or may hereafter have for or by reason of any cause, matter or thing whatsoever existing up to the present time, and in particular without limiting the generality of the foregoing generally release the said Releasee from all claims which relate to lease payments (including interest payments) owing to the Releasor by the Releasee under Master Equipment Lease No. 838 dated as of July 30, 1999 and all Equipment Schedules executed between the Releasee and Releasor thereunder ("Leases").*

***PROVIDED THAT** the continuing obligations of the parties to the Leases, as set forth in the Leases and as modified by the Minutes of Settlement, are not hereby released.*

It is acknowledged that the Releasee does not admit any liabilities or obligations whatsoever to the Releasor and such liabilities and obligations are in fact denied.

The Releasor further agrees and undertakes not to make any claim or take any proceedings against any other person or entity which might be entitled to claim contribution or indemnity from the Releasee.

***IN WITNESS WHEREOF**, the said Releasor has executed this Release by its proper officer duly authorized in this regard, this 31st day of December, 2001.*

WITNESS:	*MFP FINANCIAL SERVICES LTD.*
	Per:
______________________________	______________________________
	Name:
	Title:
WITNESS:	*AZTEC LIMITED PARTNERSHIP*
	Per:
______________________________	______________________________
	Name:
	Title:

SCHEDULE "D"

JOINT ANNOUNCEMENT OF THE CITY OF TORONTO AND MFP FINANCIAL SERVICES LTD.

The City of Toronto and MFP Financial Services Ltd. announced today, after an exhaustive review of all transactions between them, that they have resolved all outstanding issues between them on a basis both believe to be fair and reasonable. Their agreement involves, in part, the settling of amounts that each owes to the other. It also involves the restructuring of certain equipment leases, in respect of which MFP has agreed to buy down future lease payments and the City has agreed to a corresponding benefit to MFP. In the result, MFP will provide to the City a credit in the amount of $3,220,000 against amounts owing to MFP and the City will immediately pay the balance to MFP.

TERMS OF SETTLEMENT

(Released in public on December 20, 2001.)

Financial Aspects

(1) The City owes MFP $8,373,182.00 for outstanding lease payments since April 2001 to and including December 1, 2001;

(2) MFP will give the City credit for $3,220,000.00 against amounts owing;

(3) The City will pay MFP $5,153,182.00; and

(4) It is to be noted that no late payment interest penalty will be charged by MFP on the sum of $8,373,182.00.

Explanation of the $3,220,000.00

(5) The City has a claim of $2,700,000.00 for payments to be made in 2004 and 2005 for computer leases that extend beyond 60 months to 63 and 66 months. This claim is being made by the City because the computer equipment has no useful value after five years. The City therefore should not be paying any amounts at that time. MFP is prepared to recognize the present value of those monies at $2,396,000.00;

(6) MFP failed to pay, for a lengthy period time, for equipment that it had purchased from the City of Toronto. The City claims $460,000.00 for outstanding interest on the monies withheld. The interest claimed is at four percent, which is the percentage expressed in the Agreement with MFP. MFP is prepared to recognize this amount;

(7) On the Oracle Leases, MFP is prepared to recognize the City's claim of interest on amounts pre-paid by the City, but which will not have to be paid by MFP to Oracle until the future. This claim, at four percent, is $430,000.00; and

(8) The total of these claims is $3,286,000.00. MFP is prepared to recognize these claims at the figure of $3,220,000.00.

Value

(9) MFP has a claim, by the provisions of the lease, for interest on the outstanding lease payments of $8,373,182.00. The interest rate is at two percent per month or 24 percent per annum. The interest claim is $1,300,000.00. MFP is prepared to forego all of this interest. The value that the City is thus obtaining is forgiveness of $1.3 million of interest and a credit against amounts owing of $3,220,000.00 for a total of $4.5 million.

Non-Financial Aspects

(10) Releases will be given to MFP by the City releasing all of its officers, directors, and employees and assigns from any further claim;

(11) No Releases will be given in respect of any present or former City Employee or Councillor;

(12) A Joint Statement will be issued setting out that against outstanding lease payments, a credit has been given of $3,220,000.00 and that no interest is being claimed by MFP on the outstanding payments. There will be no statement either absolving MFP from blame or lauding them for their conduct; and

(13) MFP has agreed to co-operate with the City auditor or any investigator appointed by the City to submit to interviews. It will also provide copies of all expense reports for entertainment expenses with City Employees or Councillors.

Payment for Additional Equipment

(14) The City will pay MFP $3,901,788.00 for equipment in its possession which was purchased by MFP for the City at the City's request, but with respect to which no leases have been executed. No interest is being charged to the City for the past use of this equipment.

(15) The City will pay various suppliers $1,662,574.86 for equipment currently in the City's possession which MFP ordered at the City's request, but with respect to which no leases have been executed. No interest is being charged to the City for the past use of this equipment.

(City Council also had before it, during consideration of the foregoing Clause, a confidential joint report (February 7, 2002) from the Chief Administrative Officer and the City Auditor, such report to remain confidential in accordance with the provisions of the Municipal Act, having regard that it concerns the security of the property of the municipality and pertains to litigation, save and except the following recommendations embodied therein:

"Recommendations:

It is recommended that:

(1) if Council decides to proceed with litigation against MFP, then staff be authorized to spend up to $5.76 million for costs resulting from litigation;

(2) funding in the amount of $4 million be made available from the 2001 Operating Surplus to be set aside as a contingency pending the outcome of any litigation and/or inquiries;

(3) the Chief Financial Officer and Treasurer report back to Council with additional funding sources for costs in excess of $4 million that result from litigation; and

(4) the appropriate City officials be authorized and directed to take the necessary actions to give effect thereto.")

(City Council also had before it, during consideration of the foregoing Clause, a confidential joint report (February 13, 2002) from the Chief Administrative Officer and the Commissioner of Corporate Services, such joint report to remain confidential in accordance with the provisions of the Municipal Act, having regard that it concerns the security of the property of the municipality and pertains to litigation, save and except the following recommendations embodied therein:

"Recommendations:

It is recommended that:

(1) direct settlement of the outstanding accounts totalling about $1.9 million by the City with suppliers of technology-related acquisitions, where such acquisitions were made prior to last year's freeze on new leases but were not financed through leasing, be approved;

(2) the appropriate staff be directed to settle these outstanding accounts with advice from the Acting City Solicitor and the external solicitor for the MFP review;

(3) the Emergency Technology Acquisition Reserve Fund be made available as internal financing for these acquisitions. The repayment of the Fund be structured with the acquiring departments under the same terms and conditions already established for the administration of the Reserve Fund. The internal repayments will begin in 2002; and

(4) authority be granted for the introduction of any Bills that are required.")

(City Council also had before it, during consideration of the foregoing Clause, a confidential report (February 5, 2002) from the City Auditor, such report now public in its entirety:

Purpose:

To provide an update on the continuing investigation relating to the City's dealings with MFP Financial Services.

Financial Implications and Impact Statement:

There are no financial implications in relation to this report.

Recommendation:

It is recommended that this report be received for information.

Background:

At its meeting of December 4, 5 and 6, 2001, the City Auditor was requested to:

(a) undertake the further investigations as instructed by City Council at the in camera portion of its meeting; and

(b) continue to investigate and report to the Audit Committee:

- *purchase or lease of Council orginal equipment (IT) and the whereabouts of this equipment;*

- *whether the City had been reimbursed for this equipment;*

- *whether proper approvals for the actions were received; and*

- *details surrounding the acquisition of this equipment by the Toronto Transition Team, such as the minutes of meetings, the bid process, bid proposals, the authorization of the Purchase Orders, the signatures on the contract and the interest rates on this contract or contracts."*

In relation to (b) above, the City Auditor has completed this review, the results of which are the subject of a report dated January 28, 2001 entitled "Leasing Contract Between City of Toronto and MFP Financial Services – Councillors Computer Equipment".

The in camera instructions to the City Auditor were as follows:

> *"the City Auditor, using appropriate external resources, be instructed to conduct all necessary investigations to determine if the individuals identified in the report or any other former City of Toronto staff received any benefit contrary to their obligations to the City of Toronto (including strict enforcement of Conflict of Interest), or contrary to their legal obligations and duties under any applicable law;*
>
> *the City Auditor, when conducting the investigation requested in Recommendation No. (2), above, be requested to consider, after the review of the work done by KPMG, engaging another forensic auditor for the continuation of this investigation."*

Comments:

In regard to the in camera instructions, further investigations in the area requested are extremely difficult. The City Auditors authority, for example, is limited to staff and records within the City and, as a result, access to external information is generally not possible. MFP Financial Services Limited, for instance, have indicated through their legal advisors that they are not prepared to provide specific information relating to benefits that they may have provided to City employees. MFP have also indicated that, as this is the subject of litigation between them and the City, they are not prepared to discuss this issue further.

At the request of the City Auditor, KPMG have conducted follow-up interviews with both the former Chief Financial Officer and Treasurer, as well as the former Executive Director of Information & Technology Division. In each case, the question of benefits was raised and, other than those instances identified in the report entitled "Review of Computer Leasing Contract between City of Toronto and MFP Financial Services", no further information was provided.

The City Auditor has met with a number of external forensic auditors, particularly in the context of further forensic work requested by the Audit Committee. While other forensic auditors are being considered for this work, it is the City Auditor's view that KPMG should continue in the lead role for matters relating to the MFP review. KPMG are familiar with the details of the investigation and have conducted extensive interviews with a significant number of staff. A switch from KPMG to another forensic audit firm would involve a significant reorientation by them, which would likely not be cost effective and at the moment is not appropriate. In any event, other than a number of issues currently being followed-up by the City Auditor, there is probably no further need to use KPMG or any other forensic auditor to conduct any substantive additional investigative work.

Conclusions:

Further investigative work in relation to the issue of possible benefits received by staff and former staff is extremely difficult. The City Auditor has no access to information external to City records.

The City Auditor has determined that further investigative work, if required, will continue to be conducted by KPMG.

Contact:

Jeffrey Griffiths, City Auditor, Tel: (416) 392-8461, Fax: (416) 392-3754
E-Mail: Jeff.GRIFFITHS@city.toronto.on.ca)

(City Council again had before it, during consideration of the foregoing Clause, the following confidential joint report (December 3, 2001) from the Chief Administrative Officer, the Commissioner of Corporate Services, and the City Solicitor, such report now public in its entirety:

Purpose:

The purpose of this report is to obtain instructions from Council to pay to MFP Financial Services ("MFP") the amount recommended by the City's consultants as owing to MFP and to retain the balance of funds to set off amounts claimed against MFP in the event of future litigation.

Financial Implications and Impact Statement:

The City has been retaining approximately $8 million which would have otherwise been paid to MFP but for the investigation of the MFP contract. The payment of $4 million at this time to MFP would minimize the exposure to MFP in the event that current settlement negotiations are unsuccessful and MFP commences a court action for unpaid monies.

Recommendation:

It is recommended that staff be authorized to proceed strategically with the payment of monies to MFP Financial Services as set out in the body of this report.

Background:

At its meeting on November 29, 2001, the Audit Committee had before it a confidential report from the Chief Administrative Officer and City Auditor in respect of the investigation of the Information and Technology Computer Hardware and Software contract with MFP. The City has been withholding monies otherwise owing to MFP under the contract pending the results of the investigation. Settlement discussions are ongoing with MFP to resolve this matter without resort to litigation.

The City's outside counsel in this matter, Alan Lenczner of Lenczner Slaght Royce Smith Griffin, is recommending a course of action in relation to the monies held back in order to reduce the exposure of the City in the event the settlement negotiations are unsuccessful. In such an event, litigation is likely to ensue. In the opinion of outside counsel, the City has an arguable claim against MFP for an amount of $3- $4 million. Counsel believes there is considerable strategic advantage for the City to be a plaintiff as opposed to a Defendant and Counterclaimant.

Given (a) the risk that MFP may launch an action against the City for outstanding payments (b) that $8 million remains unpaid to MFP and (c) the City's arguable claim is in the above-noted range of $3-$4 million, outside counsel recommends immediate payment to MFP of $4 million. The remainder of the $8 million would be held back and used to set off amounts claimed against MFP in the event of future litigation. Outside counsel are also seeking instructions to prepare a draft Statement of Claim in order that the City would be in a position to move quickly as a plaintiff in the event settlement discussions break down.

Conclusions:

It is in the City's interest to strategically make an immediate payment of $4 million to MFP and to instruct outside counsel to prepare a Statement of Claim for the balance of the $8 million held by the City in the event settlement discussions with MFP prove unsuccessful.

Contact:

James Anderson, Director, Municipal Law
Telephone: 392-8059; Fax: 397-5624; janders1@city.toronto.on.ca)

(City Council again had before it, during consideration of the foregoing Clause, the following confidential joint report (November 29, 2001) from the Chief Administrative Officer and City Auditor, such report now public in its entirety:

Purpose:

This report sets out the findings of a review of the City's business relationship with MFP Financial Services Ltd. (MFP) of Mississauga Ontario. It is the final report of a three-month review into the nature of the City's contractual relationship for leasing computer hardware and software. It includes an examination of the role of staff in making a number of key changes to the arrangements with MFP and the impact of those changes.

Financial Implications and Impact Statement:

The financial implications of this report can be addressed from existing budgets.

Recommendations:

It is recommended that:

(1) the Chief Administrative Officer lead a comprehensive strategy to significantly enhance the City's business processes, accountability, transparency, and human resource competencies. That strategy should include, but not be limited to, the recommendations below;

(2) a steering committee of appropriate senior staff work with the CAO to support the development and implementation of the strategy;

(3) the Chief Administrative Officer put in place stringent standardized life cycle management rules for the management of City contracts by September 2002. A central component of those rules should be a project charter template for all large acquisition and contract projects. The project charter should clearly delineate accountability for all aspects of the contract life cycle;

(4) the Chief Administrative Officer, with the assistance of the City Solicitor, develop written policies and procedures on contract changes. The policies should specify when changes to existing contracts require Council approval, further financial analysis, legal review, or the issuane of a new RFP or RFQ;

(5) where possible, all future contracts be designed and negotiated to protect the City's interests should priorities or needs change. Therefore, contracts should, wherever possible, include review processes, re-negotiation windows, cancellation provisions, and full or partial exit provisions;

(6) the Chief Administrative Officer and Commissioner of Corporate Services develop a contract management centre of excellence in Corporate Services I&T Division using existing funds and 2001 under-expenditures. The centre should include highly skilled technical experts and all necessary resources to assess, issue, review, manage and evaluate major contracts. The centre should include, at a minimum, expertise in financial analysis, contract law, and negotiation. The staff of the centre should have, or be working towards, nationally or internationally recognized professional qualifications

in contract management. The business processes of the centre should similarly reflect or fully adopt international standards for contract management. The centre should be implemented early in 2002; and

(7) the Chief Administrative Officer, in consultation with the City Auditor, report to the Audit Committee in the spring of 2002 on a strategy to undertake ongoing 'value for money' audits of major contracts and outsourced services.

The Chief Administrative Officer ensure that the City's approved conflict of interest policy is fully implemented, and that all levels of management ensure that there is rigorous and consistent application and compliance. The opportunity for conflict of interest can be created by the contractor. Therefore the city's conflict of interest policy should be included with requests for proposal and quotations.

Background:

In May of 2001 the Chair of Audit Committee raised concerns that the City's contract with MFP had been used in a way that exceeded the original intent and approvals of Council. Specifically, the Chair of Audit Committee argued that Council had not approved the use of MFP as a vendor of record beyond very specific Y2K related purchases.

In May of 2001, the Acting Executive Director of Information Technology initiated a review by legal staff of the issues raised by the Chair of Audit committee. This culminated in a meeting of City purchasing and legal staff on July 23rd, 2001 to examine this issue. At that meeting legal staff presented a preliminary position that City staff did not have the authority to use the MFP lease beyond a $43 million threshold approved by Council in 1999.

The next day, July 24th, 2001, City staff became aware of media reports about the City of Waterloo's contract with MFP Financial Services. The reports suggested that the City of Waterloo was initiating legal action against MFP in relation to alleged changes in the interest rates implicit in their contract. A report in front of Toronto City Council recommending MFP as the successful bidder in an RFP to lease City photocopiers was referred back to staff at the request of the acting CAO.

City Financial Planning staff undertook a preliminary review of the implicit effective interest rates arising from the City's contract with MFP. This initial analysis suggested that there had been dramatic increases in the effective interest rates. As well, the initial review revealed significant inconsistencies between the original Council approval and the current arrangements with MFP.

The acting CAO created a working group to undertake a thorough analysis. The working group included the Commissioner of Corporate Services, the City Solicitor, and the Acting Executive Director of Information Technology. In addition, because of possible audit implications, the City Auditor was requested to participate in the review. City Council was informed by a memo from the Acting CAO that a review was underway and that the results would be reported out to the appropriate committee of Council.

It quickly became apparent that the City lacked the technical expertise to properly analyze the highly complex lease documents and schedules, particularly because the schedules to the lease had changed on a number of occasions. On the advice of the City Auditor, an external lease expert, Mr. Greg Dorbeck of Pivotal Technologies, was contracted to undertake an examination of the lease. At the same time all documentation related to the MFP lease was collected by Finance and I&T staff and consolidated in the office of the City Solicitor.

In the early weeks of the review, it was further apparent that there were questions about key decision points related to the lease. It was evident that current and former City staff had made decisions and authorized changes to the lease that had significant financial implications. It was therefore necessary to undertake a review of staff decisions that would require interviews of current and former staff. It was determined by the acting CAO that there were, at that point, two key elements of the review; an analysis of the financial implications of the lease; and an analysis of the staff behaviour in relation to the lease. The Acting CAO engaged the services of KPMG to ensure that the review of staff behaviour was done in a strictly objective manner.

It also became necessary to contract with external legal advisors. In March of 2000, a member of the City Solicitor's staff issued a letter to MFP, at MFP's request, stating that certain agreements with MFP had been duly authorized by the City, the persons executing the agreements were authorized to do so, and the agreements were legal, valid and binding agreements of the City. Because legal staff had to be interviewed in the course of the interview, the City Solicitor felt that external legal advice was needed to ensure the appearance of objectivity.

On the advice of both City and external legal counsel, in order to protect the City's options, the City has not paid any amounts owing MFP since the beginning of the review. Certificates acknowledging receipt of delivered computer equipment have also not been signed by the City. No new business has been undertaken with MFP. As a result of not paying lease payments the City may be subject to late payment penalties and interest on late payments.

Throughout the review, weekly or semi-weekly meetings of the review team were held with the external experts. During the course of the review all available documents were collected, but it quickly became apparent that many of the key decision points related to the lease had little or no supporting documentation.

A series of meetings have been held with MFP, both to obtain documents relevant to the review, and to discuss some of the findings. It should be stated that MFP has been very helpful in agreeing to meet with the City and its external advisors and in providing documents and records. More recent meetings have been held with MFP to examine compensation to the City for amounts believed by the City to be owing. The City is of the position that it is immediately owed certain amounts by MFP. The results of these discussions will be the subject of another report.

Comments:

There are a number of major areas of focus arising from the review. Each major finding is examined individually.

RFQ and Report to Council

In early 1999 staff were exploring financing options for the large-scale computer acquisitions anticipated for Y2K. Leasing was recommended as an approach because it reduced the initial capital outlay and stabilized year to year payments and budgets. To this end, an RFQ was issued on May 31 of 1999 to solicit bids for computer leasing. Six companies bid on the RFQ.

The RFQ did not request an effective interest rate, only a payment rate quoted as an amount per $1,000 of purchase value. The rate to be quoted in bids was for the first 90 days only of a three-year lease (the rate quoted would apply to the duration of all leases entered into during the 90-day period). Respondents were also required to include in their submissions a description of the mechanism for setting the lease rates beyond the initial 90 days. Some bidders linked their future rate to government bond yields. MFP had a much more general statement that future rates would be set "…to reflect changes in technology and the prevailing market conditions which includes the underlying base interest rate."

The report to Council in July of 1999 failed to mention that the rates quoted in the responses to the RFQ, and on which the analysis was done and MFP recommended, were only in effect for 90 days, after which they could change. An early draft of the report did conclude that leasing was the lower cost option "assuming leasing rates remain at the existing level for future periods." This important caveat was edited out of the final version, apparently by the former Chief Financial Officer.

The contract with MFP was signed after the 90 day period expired. It is important to note that, consistent with the RFQ requirements, all respondents to the RFQ quoted rates that were only valid for 90 days and that all could have changed their rates after that period.

MFP was recommended based on the 90-day lease rate that was substantially lower than the other bidders. The implicit effective interest rate of the MFP proposal was 4.6%, which was lower than the City's cost of borrowing. Most of the other bidders had an effective interest rate of approximately 9%. However, as stated above, the report failed to mention that the MFP rate was only valid for 90 days and was then subject to change, as were the rates quoted by the other companies.

Five year initial lease term

The various contractual documents constituting the business arrangements with MFP are numerous and complex. The master contract with MFP was reviewed by outside legal 'as to form' only. Most of the equipment leased is included in a number of equipment schedules that are sub-documents of the master lease. In total, the City has entered into 15 equipment schedules with MFP, three of which have since been terminated and re-written.

With two exceptions, the initial leasing schedules were not for three years as approved by Council, but were for longer terms, most commonly five years. The extension of leases from three to five years appears to have been initiated by the former Chief Financial Officer in order to reduce annual lease expenditures and thereby reduce annual budget pressures. However, the extension of the lease term increased the total financial cost to the City over the term of the agreement.

In addition, when the initial lease was signed in October of 1999 for five years, the rate of interest implicit in the lease payments was significantly higher than the interest rate implicit in MFP's bid, and on which Council made its leasing decision. The new implicit interest rate was 6.5%. This also increased the City's total financial obligation. There is no evidence that any analysis was undertaken of the financial impact of extending the lease term or the new payment rate.

Many City staff suggested that a motion moved by a former member of Council, the former Budget Chair, at the Policy and Finance Committee meeting in July of 1999, constituted approval for staff to extend the term of the lease. The motion, which was subsequently approved by Council, generally suggested that staff take steps to ensure that "…the terms and conditions of the lease be flexible enough to ensure that the life span of the computer equipment is extended beyond three years."

In the opinion of the City Solicitor, this motion does not grant staff the authority to extend the term of the lease to five years, only to take such steps to acquire or otherwise retain equipment that might have a useful lifespan beyond three years. The City Solicitor argues that a motion that allows for a lease beyond three years would fundamentally negate the premise of the base report. That report, the analysis on which the report is based, and the council decision are entirely predicated on a three year lease term.

<u>*Sale Lease Back of previously purchased equipment*</u>

Between January 1999 and the signing of the first equipment schedules with MFP, the City purchased a large amount of computer equipment and software in preparation for Y2K. In the fall of 1999, staff initiated a sale and lease back transaction of this equipment with MFP. All of the previously purchased equipment was sold to MFP and leased back by the City. Additional equipment was purchased by the City and sold to MFP and leased back through 2000. In total, $23.5 million dollars of equipment was sold to MFP and subsequently leased back to the City. There is no mention of a sale leaseback in the RFQ or the report to Council. In the opinion of the City Solicitor, the sale leaseback was not properly authorized, and should have been approved by Council. In addition, specific transactions undertaken during the sale leaseback were undertaken by staff who lacked the appropriate authority.

Many staff indicated when interviewed that there was an implicit understanding that a sale leaseback would be a component of the lease arrangement from the outset.

The review also identified problems with the manner in which the City was compensated for the sale leaseback. The $23.5 million was not immediately paid to the City when the transaction occurred, but was held by MFP, some of it for 18 months. Two lump sum payments were made to the City, one for $4.2 million in May of 2000, and one for $4.7 million in May of 2001. The remainder of the amount owed by MFP to the City was used to offset lease payments due to MFP by the City. The lost interest to the City as a result of this delay in payment is approximately $460,000. Recovery of this amount is now the subject of discussions with MFP. In addition, City staff failed to collect from the federal government a GST rebate due the City worth approximately $1.8 million. Staff are now attempting to recover the rebate.

Lease Restructuring of July 2000

In the summer of 2000 a number of the leases were restructured and, in the course of this restructuring, the term of some leases was extended beyond the initial five year period. City staff generally stated that the change was initially suggested by MFP as an administrative convenience. The former Chief Financial Officer stated that there was an assumption that this was an administrative change only and had no financial impact. The review suggests that the restructuring was approved by the former Chief Financial Officer.

During the restructuring, equipment was resorted into five new schedules. All printers were placed in one schedule, laptops in another, etc. As a result of this lease restructuring, the majority of the equipment in the restructured lease schedules now has a term of 5½ years. Some other equipment in the restructured lease schedules now has a term of either 5 years or 5¼ years.

This restructuring did have a financial impact. The total obligation of the City increased. Moreover, the restructuring failed to take into account payments that had already been made by the City on the equipment placed into the restructured lease. This represents a financial impact to the City of $2.7 million, all of which is profit for MFP. The payments which result in this additional cost to the City will arise at the end of the lease term (i.e., the final additional payments to be made 2005).

No financial analysis was done by City staff of the restructuring. The restructuring was not approved by, or reported to, Council.

Total Amount Under Lease

Council approved the leasing of $43 million of computer equipment for three years at an effective interest rate of approximately 4.6%. However, the City is currently leasing $80.5 million in assets from MFP. Virtually all computer equipment acquired by the City in 2000 and 2001 was leased from MFP. The review found that there was a pervasive belief across finance, purchasing and I&T staff that the MFP lease was to be used exclusively for computer leasing, and that this was appropriately approved.

In the opinion of the City Solicitor, there is no Council authority to lease more than $43 million of computer equipment.

The Council direction from July 1999 directed that the former Chief Financial Officer and former Executive Director of Information and Technology report back on future or additional leasing opportunities. There have been no subsequent reports.

Staff Behaviour

As part of the review of staff behaviour, KPMG was specifically asked to consider whether there was evidence of staff impropriety in relation to the contract. KPMG has concluded that there is no evidence that staff profited from the transaction.

However, there are conflict of interest issues. Senior City staff accepted hockey tickets and meals from MFP before the issuance of the RFQ, and after the contract was signed. The former Chief Financial Officer accepted 'less than 12' hockey tickets from the company, and travelled on a chartered aircraft to a hockey game in Ottawa. The former Chief Financial Officer has produced a cancelled cheque made out to a senior executive of MFP for $700 to offset the cost of that trip.

The electronic schedule calendar of the former Executive Director of Information and Technology indicates that he had a number of lunch meetings scheduled with representatives of MFP. Correspondence from MFP indicates the former Executive Director of Information and Technology had a longstanding relationship with MFP dating from his previous employment with the provincial government.

In addition, the former Executive Director of Information and Technology, former Chief Financial Officer, and Director of the Y2K Project posed for a photograph in the 2000 MFP annual report. The same testimonial appeared on the company's website, and provided statements of endorsement of the company. The website photo and endorsement were removed from the company website in July of 2001 at the request of the acting CAO.

In the opinion of Ross Dunsmore of Hicks Morley, Barristers and Solicitors, who was the solicitor involved in training staff respecting the conflict of interest policy, "…the conduct of the former Chief Financial Officer violated her contractual duty to recognize and avoid circumstances giving rise to the appearance of conflict of interest. The formal policy of Council itself is quite strict. Employees may not accept favors. This would certainly cover hockey tickets and meals. However, the policy has been administered by degree, so that receipt of sporadic favors has been permissible. Unfortunately, with hindsight the number of favors coming from one company in this case goes over the acceptable line. The perception is that MFP engaged the former Chief Financial Officer in a conflict, the result of which she did not scrutinize certain dealings as scrupulously as she might have otherwise. Certainly, some of the problem falls at the feet of MFP who enticed the city employee, but the former Chief Financial Officer should have acted differently."

Financial Impact

The calculation of the financial impact to the City is complex because it is a factor of both lease rate changes, changes in the length of the lease term, and other factors. In addition the precise financial impact is contingent on the City making a decision, as yet unmade, on whether to buy out the computer equipment at the end of the lease. Moreover there are several possible baselines against which to measure the impact to the city. The following sets out the key impacts.

The total impact to the City of the changes in lease terms and rates is $13.5 million dollars. This amount is the difference between leasing $80.5 million of computer equipment at 4.6% for three years, and the current lease lengths and rates.

However, comparing the City's current obligation to the rate proposed in the original MFP lease is problematic. It was understood by MFP and city staff from the outset that the rates would change during the course of the lease and would not remain fixed at 4.6%. This fact was, however, not reported to Council. The Council report can therefore leave a reader with the erroneous impression that the initial rate would remain fixed for the duration of the lease term.

It is also important to note that the initial purchase/lease analysis was based on MFP's proposed lease rate with an implicit effective interest rate of 4.6%. At the current lease rate the purchase/lease analysis may not hold.

There are possible future financial impacts for the City related to the lifespan of the equipment under lease. The current leases require that the City continue to pay for most of the City's computer infrastructure into 2005. While every attempt will be made to maximize the lifespan of the computer equipment purchased in 1999, some elements of that infrastructure do not have a five to six year lifespan. Some network devices, servers, storage devices (particularly those that operate 24 hours a day) typically have short lifespans and will have to be replaced or upgraded before 2005, in some cases in 2002-3. That means that the City will inevitably find itself in a position of continuing to pay for some equipment that has been replaced and disposed of. There are also likely to be operational impacts in attempting to extend the life span of the City's desktop computers to five and a half years. The City will reach a point where newer business applications will not run on the current computers.

The analysis by KPMG and Mr. Dorbeck, indicates that in addition to the amounts above, as a result of the restructuring of July 2000 the City will pay $2.7 million more to MFP than it would have had the leases not been restructured. In addition, the City has suffered $460,000 of lost interest arising from delayed repayment of the sale leaseback interest, and is owed an additional $100,000 by MFP as a result of other technical errors. The City may also be owed additional interest of approximately $430,000 as a result of an unusual payment structure of one of the larger software leases.

The City owes MFP approximately $7.5 million in lease invoices that remain unpaid starting in June 2001. Interest on these payments is estimated to be $374,000. MFP claims that an additional one million is owed in respect of interest on lease schedules that have not yet been signed by the City and various other claimed late lease payments.

Conclusions:

The handling of the leasing contract with MFP represents a major accountability failure with serious financial implications for the City of Toronto. The failure was not caused by one single factor, but by several.

(1) The report to Council authorizing the leasing arrangement with MFP was seriously flawed. It failed to provide Council with the necessary information to make a fully informed decision. In particular, the report failed to mention that the payment rates would change every 90 days for new leases.

(2) MFP's rate setting provision was vague. Concerns raised by one finance staff member about the vagueness of the provision were not pursued.

(3) *There was no clear acceptability framework set out for managing the contract. As a result staff repeatedly assumed, incorrectly, that other staff were undertaking necessary financial reviews of changes to the contract.*

(4) *Staff had little experience with leases and the complex financial analysis and contractual arrangements that are associated with leasing.*

(5) *The agreement was undertaken in the context of Y2K, during which large spending decisions were being made rapidly, and normal purchasing requirements had been modified.*

(6) *Staff used the contractual documents provided by the company, that were complex and likely structured to the company's advantage, without comprehensive review or negotiations.*

(7) *Changes were made to the lease and schedules with little or no financial impact analysis.*

(8) *Finally, it is reasonable to believe that the extra-professional social relationship key staff had with MFP may have compromised their objectivity, and therefore their ability to exercise proper due diligence.*

While the issues raised above represent a serious concern, it must be stressed that the City's responsibility for this problem rests with a very small number of senior individuals, some of whom have since left the City. The majority of staff who were involved in administering the contract did so in good faith and with appropriate professionalism. The vast majority of staff in Finance and Corporate Services I&T had little or nothing to do with the contract.

Finally, the findings of this report are in many cases consistent with the findings of the reports by the City Auditor and CAO on the use of consultants. There are common themes and issues in both this report and the report on consultants. There are common causes, and many cases the same senior staff played key roles. Through 1999 and 2000, and particularly through the Y2K project, the City entered into a number of agreements with the private sector some of which were poorly structured, improperly analyzed, managed sloppily, inadequately documented, and questionable in scale and scope. A separate report recommends a review of Y2K spending.

This report makes no excuses for those lapses. The recommendations of this report and the report from the CAO on the use of consultants are intended to form a comprehensive strategy to ensure that these sorts of problems never occur again. However, the necessary changes must be made by staff. This means that the staff in Finance and Corporate Services and I&T need the full confidence and support of Council as new business processes are developed and implemented. In order to move forward it is absolutely essential that City staff who must implement these improvements receive the full support of all members of Council.

Contacts:

James Ridge, Acting Executive Director of Information Technology;
Jeff Griffiths, City Auditor)

(A copy of an attachment to the foregoing report, entitled "Changes in City's Obligation – MFP Lease" is on file in the office of the City Clerk.)

(City Council again had before it, during consideration of the foregoing Clause, the following confidential report (December 5, 2001) from the City Solicitor, such report now public in its entirety:

Purpose:

The purpose of this report is to report to Council for further direction on the release publicly of a draft report, dated December 5, 2001, by the Chief Administrative Officer and City Auditor, the latter report being directed by Council at its meeting on December 4, 2001.

Financial Implications and Impact Statement:

There are no financial implications by the receipt of this report.

Recommendations:

It is recommended that the draft public report, dated December 5, 2001, of the Chief Administrative Officer and City Auditor, attached to this report, not be publicly released or received by Council.

Background:

At its meeting on December 4, 2001, Council had before it a confidential report, dated November 29, 2001, from the Chief Administrative Officer and the City Auditor. Council directed that staff provide a public report setting out information pertaining to the subject computer leasing contract between the City and MFP Financial Services ("MFP").

Comments:

There are a number of sensitive issues arising out of the in camera report all of which have potential adverse impacts on the City. There is the issue of potential litigation with MFP, the effect of any public disclosure and associated press attention on the current negotiations with MFP and the related issue of staff involvement which may or may not lead to dismissal or other action. These issues are all intertwined in attempting to build a legal strategy in relation to MFP.

As well, it is difficult to provide the background information publicly at this time without attracting the additional issue of the potential liability to other bidders in the computer leasing RFP evaluation process and the award by council to MFP. This may be better handled after determining a final position in relation to MFP and after a complete understanding of any culpability by MFP, as for example, in making misrepresentations to staff.

There is another concern pertaining to the ability of staff and councillors to withhold the confidential sensitive information when the public report will galvanize questions by the press on the facts in any public report. It may well be the result that any implications of staff impropriety will be seized on by the press, will overbroadly taint staff with culpability and the CAO and staff will be unfairly handcuffed in replying. The information in the draft will only engage a public debate and that debate, in the opinion of staff and the outside consultants is premature.

Contact:

James Anderson
Director, Municipal Law
392-8059
(fax) 397-5624
janders1@city.toronto.on.ca

(Draft Report dated December 5, 2001,
from Chief Administrative Officer and City Auditor,
entitled "Review of the computer leasing contract between
the City of Toronto and MFP Financial Services")

Purpose:

The purpose of this report is to report publicly to Council as directed by it.

Financial Implications and Impact Statement:

N/A

Recommendations:

It is recommended that this report be received for information.

Background:

At its meeting on December 4, 2001, Council had before it a confidential report, dated November 29, 2001, from the Chief Administrative Officer and the City Auditor. Council directed that staff provide a public report setting out information pertaining to the subject computer leasing contract between the City and MFP Financial Services ("MFP").

Comments:

The following constitute the facts forming the background of the investigation.

(a) Facts:

In May of 2001 the Chair of Audit Committee raised concerns that the City's contract with MFP exceeded the original intent and approvals of Council. Specifically, the Chair of Audit Committee argued that Council had not approved the use of MFP as a vendor of record beyond very specific Y2K related purchases.

In May of 2001, the Acting Executive Director of Information Technology initiated a review of the issues raised by the Chair of Audit committee.

On July 24, 2001, City staff became aware of media reports about the City of Waterloo's contract with MFP Financial Services. The reports suggested that the City of Waterloo was initiating legal action against MFP in relation to alleged changes in the interest rates implicit in their contract. A report in front of Toronto City Council recommending MFP as the successful bidder in an RFP to lease City photocopiers was referred back to staff at the request of the acting CAO.

The acting CAO created a working group to undertake a thorough analysis. The working group included the Commissioner of Corporate Services, the City Solicitor, and the Acting Executive Director of Information Technology. In addition, the City Auditor was requested to participate in the review. City Council was informed by a memo from the Acting CAO that a review was underway and that the results would be reported out to the appropriate committee of Council.

It quickly became apparent that the City lacked the technical expertise to properly analyze the highly complex lease documents and schedules, particularly because the schedules to the lease had changed on a number of occasions. On the advice of the City Auditor, an external lease expert, Mr. Greg Dorbeck of Pivotal Technologies, was contracted to undertake an examination of the lease.

It was determined by the acting CAO that there were two key elements of the review; an analysis of the financial implications of the lease; and an analysis of staff decision making and management systems in place in relation to the lease. The Acting CAO engaged the services of KPMG and external legal advisors to ensure that the review was done in a strictly objective manner.

Throughout the review, weekly or semi-weekly meetings of the review team were held with some of the external experts. During the course of the review all available documents were collected, but it quickly became apparent that many of the key decision points related to the lease had little or no supporting documentation.

A series of meetings have been held with MFP, both to obtain documents relevant to the review, and to discuss some of the findings. It should be stated that MFP has been very helpful in agreeing to meet with the City and its external advisors and in providing documents and records.

There are a number of major areas of focus arising from the review.

RFQ and Report to Council

In early 1999 staff were exploring financing options for the large-scale computer acquisitions anticipated for Y2K. Leasing was recommended as an approach because it reduced the initial capital outlay and stabilized year to year payments and budgets. To this end, an RFQ was issued on May 31 of 1999 to solicit bids for computer leasing. Six companies bid on the RFQ.

The RFQ did not request an effective interest rate, only a payment rate quoted as an amount per $1,000 of purchase value. The rate to be quoted in bids was for the first 90 days only of a three-year lease (the rate quoted would apply to the duration of all leases entered into during the 90-day period). Respondents were also required to include in their submissions a description of the mechanism for setting the lease rates beyond the initial 90 days.

The contract with MFP was signed after the 90 day period expired. It is important to note that, consistent with the RFQ requirements, all respondents to the RFQ quoted rates that were only valid for 90 days and that all could have changed their rates after that period.

Five year initial lease term

The various contractual documents constituting the business arrangements with MFP are numerous and complex. The master contract with MFP was reviewed by outside legal 'as to form' only. Most of the equipment leased is included in a number of equipment schedules that are sub-documents of the master lease. In total, the City has entered into 15 equipment schedules with MFP, three of which have since been terminated and re-written.

With two exceptions, the initial leasing schedules were not for three years as approved by Council, but were for longer terms, most commonly five years. The extension of the lease term increased the total financial cost to the City over the term of the agreement.

Sale Lease Back of previously purchased equipment

Between January 1999 and the signing of the first equipment schedules with MFP, the City purchased a large amount of computer equipment and software in preparation for Y2K. In the fall of 1999, staff initiated a sale and lease back transaction of this equipment with MFP. All of the previously purchased equipment was sold to MFP and leased back by the City.

There is no mention of a sale leaseback in the RFQ or the report to Council. In the opinion of the City Solicitor, the sale leaseback should have been explicitly approved by Council.

City staff failed to collect from the federal government a PST rebate due the City worth approximately $1.8 million. Staff are now attempting to recover the rebate.

Lease Restructuring of July 2000

In the summer of 2000 a number of the leases were restructured and, in the course of this restructuring, the term of some leases was extended beyond the initial five year period. The review indicates that the City was under the impression that this was an administrative change only and had no financial impact.

During the restructuring, equipment was resorted into five new schedules. All printers were placed in one schedule, laptops in another, etc. As a result of this lease restructuring, the majority of the equipment in the restructured lease schedules now has a term of 5½ years. Some other equipment in the restructured lease schedules now has a term of either 5 years or 5¼ years.

This restructuring did have a financial impact. The total obligation of the City increased.

Total Amount Under Lease

Council approved the leasing of $43 million of computer equipment for three years at an effective interest rate for the initial 90 day period of approximately 4.6%. Virtually all computer equipment acquired by the City in 2000 and 2001 was leased from MFP. The review found that there was a pervasive belief across finance, purchasing and I&T staff that the MFP lease was to be used exclusively for computer leasing, and that this was appropriately approved.

The Council direction from July 1999 directed that the former Chief Financial Officer and former Executive Director of Information and Technology report back on future or additional leasing opportunities. There have been no subsequent reports.

(b) Financial Impact:

The calculation of the financial impact to the City is complex because it is a factor of both lease rate changes, changes in the length of the lease term, and other factors. In addition the precise financial impact is contingent on the City making a decision, as yet unmade, on whether to buy out the computer equipment at the end of the lease. Moreover there are several possible baselines against which to measure the impact to the city. The following sets out the key impacts.

The total impact to the City of the changes in lease terms and rates is $13.5 million dollars. This amount is the difference between leasing computer equipment at 4.6% for three years, and the current lease lengths and rates.

However, comparing the City's current obligation to the rate proposed in the original MFP lease is problematic. It was understood by MFP and city staff from the outset that the rates would change during the course of the lease and would not remain fixed at 4.6%.

It is also important to note that the initial purchase/lease analysis was based on MFP's proposed lease rate with an implicit effective interest rate of 4.6%. At the current lease rate, the purchase/lease analysis may not hold.

There are possible future financial impacts for the City related to the lifespan of the equipment under lease. The current leases require that the City continue to pay for most of the City's computer infrastructure into 2005. While every attempt will be made to maximize the lifespan of the computer equipment purchased in 1999, some elements of that infrastructure do not have a five to six year lifespan. Some network devices, servers, storage devices (particularly those that operate 24 hours a day) typically have short lifespans and will have to be replaced or upgraded before 2005, in some cases in 2002-3. That means that the City will inevitably find itself in a position of continuing to pay for some equipment that has been replaced and disposed of. There are also likely to be operational impacts in attempting to extend the life span of the City's desktop computers to five and a half years. The City will reach a point where newer business applications will not run on the current computers.

Contacts:

James Ridge
Acting Executive Director of Information Technology

Jeff Griffiths
City Auditor)

(City Council again had before it, during consideration of the foregoing Clause, the following confidential report (December 20, 2001) from the Chief Administrative Officer and Acting Chief Financial Officer, such report now public in its entirety:

Purpose:

To highlight the total costs of the computer leasing program as compared to the original Council approval and to the cost of debenturing.

Financial Implications and Impact Statement:

There are no financial implications of this report.

Recommendations:

It is recommended that this report be received for information and that the contents remain confidential.

Background:

Council will be considering the computer leasing contract at its special meeting on December 20, 2001. This report is intended to assist that discussion by providing extrapolations for other financing options as they existed in 1999 and to compare these to the existing MFP lease terms.

Comments:

Council, in approving the MFP computer leasing contract at its July 27, 28, 29 and 30, 1999, meeting, had before it a report from the Chief Financial Officer and Treasurer, and Executive Director, Information Technology entitled "Leasing of Computer Equipment and Software Information Technology Products and Services". Within that report was a comparative analysis of the total costs of leasing hardware and software as compared with the City's cost of funds from debenturing.

This report presents an updated analysis of the July 1999 figures in light of the changes to the lease rates since that time and due to higher volumes of equipment and software leased.

Table 1 shows a comparison of the original comparative costs considered by Council in 1999 and the lease costs based on the original $43 million worth of equipment and software leased based on the lease rates as they existed in October, 1999, i.e. after expiry of the original 90 day rates contained in the MFP proposal. The "3 year asset life" column represents the total cost assuming that the City replaced all of the leased equipment and software at the end of 3 years, either through a lease renewal or sale of old equipment and purchase of new equipment. Debenturing was for a 3 year term. The column "5 year asset life" represents the total carrying cost over 5 years of either debenturing with a 5 year term, or exercising the purchase option under the lease arrangements at the end of the 3rd year and keeping the equipment for two more years.

Table 1. Comparative Analysis of Original $43 million Worth of Equipment and Software

	Total Cost over Term of Financing ($million)				
	3 Year Asset Life	Note	5 Year Asset Life	Note	Difference
A. Original Analysis Considered by Council In July 1999:					
Debenture Financed	46.3	1	51.4	2	5.1 due to longer debenture term
MFP Lease Proposal	41.1	3	46.9	4	5.8 due to purchase option exercised
B. Revised per October 1999 Rates					
MFP Lease Extrapolated	42.3	5	48.2	6	5.9 due to purchase option exercised
Vendor "A"	45.6	7	49.0		3.4 due to purchase option exercised

Notes:

1. *3 year debenture - assumes that equipment is sold at the end of 3rd year and proceeds are netted against cost*
2. *5 year debenture - assumes that equipment has no residual value at end of 5th year*
3. *3 year lease - assumes that purchase option at end of the 3 year term is not exercised, i.e. equipment returned to MFP*
4. *3 year lease with purchase option exercised at end of year 3 and equipment held for additional 2 years*
5. *Hypothetical scenario – calculated on basis of MFP October 1999 lease with no purchase option exercised*
6. *Hypothetical scenario – calculated on MFP October 1999 lease rates with purchase option exercised at end of 3 years on hardware only since software has no residual value after 3 years*
7. *Sample vendor rate escalated to October, 1999*

As Table 1 shows, were the original interest rates quoted in the RFP achieved, then the lease option was cheaper than the City borrowing the funds and taking full ownership of the equipment. The extrapolated actual lease payments on the original $43 million worth of equipment and software based on the October, 1999 rates exceeded the RFP cost (with the purchase option exercised) by $1.3 million ($48.2 million compared with $46.9 million). The table also shows that the total actual cost of the lease on the $43 million worth of equipment and software was less expensive than had the City financed the purchases with debentures. In other words, while the financial benefit was reduced between the quoted and the extrapolated actual costs, it was still at a lower overall cost than had the City borrowed the funds. Finally, the analysis shows that the next lowest bidder's price adjusted to October, 1999 rates was marginally lower than the debenture cost, but higher than the extrapolated MFP cost.

If the information in Table 1 is factored up to take into account the $80.5 million worth of equipment and software currently leased with the following are the total costs:

Table 2. Total Cost of Financing on $80.5 million of Equipment and Software

	Total Cost over 5 Year Term ($million)	***Note***
Debenture Financed	*95.9*	
Actual MFP Lease	*101.8*	*8*

Notes:
8. Includes all payments, including restructured leases.

This analysis shows that debenture financing would have been $5.9 million lower over a 5 year period than the actual total MFP costs.

<u>Conclusions</u>:

The original report on computer leasing considered by Council in July of 1999 considered a comparative cost of leasing versus debenture financing. Had the originally quoted RFP rates and those in existence in the first rate schedule executed in October, 1999 for the original $43 million worth of equipment and software been achieved, then Council's decision to lease would have been financially beneficial to the City. Because actual lease rates starting in 2000 were in excess of the quoted rates, the lease costs have exceeded the costs that would have been borne using debenture financing.)

(City Council also had before it, during consideration of the foregoing Clause, the following communications:

(i) (undated) chart submitted by the Executive Director, Information Technology, outlining the equipment delivered and in use, under lease, and not under lease; and

(ii) (December 20, 2001) communication from Mr. Charles Campbell, Iler Campbell, Barristers and Solicitors, addressed to Councillor Layton, with respect to a hypothetical question regarding conflict of interest, submitted by Councillor Layton.)

(City Council also had before it, during consideration of the foregoing Clause, the following Enquiry (December 31, 2001) submitted by Councillor Michael Walker:

Re: MFP Financial Services

Further to my questions to you at City Council's meeting of December 4-6, 2001, on the above subject to which you did not or were not able to answer at the time, I submit the following questions:

(1) Who signed the contract for MFP Financial Services?

(2) Who are the officers of MFP Financial Services?

(3) Did MFP Financial Services have a lawyer representing them in any of their dealings with the City over this controversial contract? If yes, what is his/her name and the name of the Law firm?

(4) Did MFP Financial Services have a lobbyist representing them at City Hall concerning this contract? If yes, what is or are their names?

(5) (a) Does MFP Financial Services have a box or access to a box at the Air Canada Centre?

(b) If it was not MFP Financial Services' box, whose box was it?

(c) Did MFP Financial Services or one of its representatives entertain municipal bureaucrats and/or politicians or their staff at the Air Canada Centre? If yes, who were they, how many times did each use it, and on what dates did each use it?

(6) (a) Does MFP Financial Services own or have access to a corporate aircraft?

(b) What type of aircraft is or was it? (i.e. a corporate jet or a propeller driven aircraft)

(c) How many City staff and/or politicians have been passengers on this aircraft? Who were they? What were the dates of these flights? What were the destinations of these flights and were these return flights from the destination(s) in question?

Though I did not receive satisfactory answers to these questions at City Council, I look forward to your written response.

(Answer (February 11, 2002) to the foregoing Enquiry, from the Commissioner of Corporate Services)

This is in response to your inquiry of December 31, 2001. I have consulted with the City Auditor and staff of the Legal Division in order to answer your questions.

Regrettably, some of the information you requested is unavailable to staff of the city. Much of the information requested is private information available only to MFP, who is not willing to provide the information to us. I can therefore only respond to this inquiry with publicly available information and have no authority to demand the production of information about ownership of certain assets, corporate entertainment expenses, or other private documents. I have responded to your questions in the same order as you have asked them.

(1) The master contract with MFP was signed by Al Shultz on behalf of the Treasurer and Jeff Abrams on behalf of the City Clerk. Mr. R. Brian Stevens, Vice President, Debt Placement & Treasurer signed the contract on behalf of MFP financial services.

(2) The officers of MFP at the time of the contract and today are listed in the attachments.

(3) MFP has in-house counsel to represent them. The corporate counsel for MFP is Suzanne Michaelson, and it is our understanding that she represented MFP in late 1999.

(4) There is no publicly available information to suggest that MFP used a lobbyist during the contract negotiations or the preparation of the RFP. MFP denies employing a lobbyist in 1999. MFP has indicated to staff that they have subsequently engaged Mr. Lyons to represent them with the province.

(5) (a) There is no publicly available information that MFP owns a box at the Air Canada Centre.

(b) It appears that MFP's account representative for the city, Dash Domi, has some degree of use of a box owned or otherwise available to his brother Ti Domi. However, this is anecdotal information only.

(c) There is no mechanism available to staff to list who attended the box as a guest of MFP. Only MFP has that information. Requests have been made of MFP to provide those records, however they have chosen not to do so.

(6) (a) Staff has no mechanism to know determine if MFP owns an aircraft. However, a review of the various public reports of MFP leaves no reason to believe that MFP owns an aircraft. Presumably they can lease or charter an aircraft. Those records would be private business records unavailable to staff of the city.

(b) Information about the method of propulsion of the aircraft is also not known.

(c) *There is no mechanism available to staff to detail who might have flown on an aircraft owned or chartered by MFP. Requests have been made of MFP to provide those records, however they have chosen not to provide those records. There is no other mechanism available to staff to answer these questions.*

Again, some of the information you requested is only available to MFP who is not willing to share it with city staff at this time.)

(A copy of the attachments listing MFP Directors 1999 and 2002, referred to in the foregoing Answer, is on file in the office of the City Clerk.)