

**TORONTO WATER DIVISION
REVIEW OF WASTEWATER TREATMENT
PROGRAM – PHASE TWO**

September 21, 2007

 Auditor General's Office

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EXECUTIVE SUMMARY

Phase Two includes a review of purchasing, payments and contract management

The Auditor General's 2007 Audit Work Plan included a review of Toronto Water's wastewater treatment program. In order to ensure the timely reporting of issues identified during our audit, our review was divided into two phases. In Phase One, reported to the September 24, 2007 meeting of Audit Committee, we reviewed controls over payroll processing, overtime and attendance management. Phase Two of our review which is the focus of this report, includes a review of purchasing, contract management, payment processing, and compliance with legislative requirements.

This report contains 18 recommendations. In our view, the implementation of these recommendations will improve controls over purchasing, contract management and payment processing. The implementation of the recommendations will also help Toronto Water achieve cost savings through more competitive procurement.

The Division has had significant reductions in staff and changes in operating processes

In recent years, the wastewater plants have experienced significant reductions in the number of staff and changes to operating processes as a result of amalgamation in 1998 and the Works Best Practices program. The Works Best Practices program was a long-term initiative that began in 1996. The objective of the program was to achieve cost savings by automating plant processes, introducing new operational tools and significantly reducing the number of plant staff.

Staff and process changes have led to changes in administrative responsibilities

Internal controls over purchases and payment processing and equipment and parts inventory require improvement. Since there are now fewer administrative staff in the plants, technical staff have assumed certain duties related to purchasing, payment processing and payroll. The focus of technical staff is on their core operational duties. As a result, administrative responsibilities have received less attention.

The level of administrative support requires evaluation

In Phase Two of our review, similar to Phase One, we have concluded that management needs to re-evaluate the level of administrative support and expertise currently provided to the wastewater plants in order to improve financial controls and allow technical staff to concentrate on their core duties.

Problems and issues identified in prior audits continue to exist in spite of clear directives from the City Manager

This audit found similar problems in three separate areas we have reported on previously. City staff continue to use departmental purchase orders (DPOs) in contravention of City policy despite clear directions from the City Manager. The non-compliance in the use of DPOs was also noted in a 2005 report from the Internal Audit Division of the City Manager's Office.

Documentation of contractor performance requires attention

Secondly, we have reported twice in the last few years on the monitoring and documentation of contractor performance. If poor performance by a vendor is not documented and used as a reference for future contract submissions, it is highly possible that the City will award contracts to contractors who have a history of not performing well.

The third area we are reporting on again is contract management. We are aware that City staff are taking steps to improve contract management.

The use of departmental purchase orders do not always comply with policy

The wastewater plants rely in large part on departmental purchase orders to purchase goods and services. Many purchases are repetitive in nature and therefore do not comply with City purchasing policies which require that DPOs are only issued for one time purchases up to \$7,500.

Savings are available by using more blanket contracts

The City could achieve significant savings if wastewater operations purchased most of their goods and services through a competitive procurement process. In 2006, the wastewater plants used DPOs for over \$9 million of purchases. We estimate that wastewater operations could save approximately \$540,000 by paying lower prices if similar purchases were combined and purchased through blanket contracts.

Barriers to developing more blanket contracts need to be addressed

Management has recognized that more blanket contracts would help the wastewater plants reduce the use of DPOs. In this context, a number of blanket contracts have recently been established. However, in order to maximize cost savings, management needs to reassess the processes in place and resources allocated to the development of blanket contracts. Proper procurement planning that communicates the nature and expected timing of purchase requests to purchasing staff began in 2006 to help expedite the preparation of contracts. This planning should be enhanced to include goods and services.

Contract management practices require improvement

The wastewater plants also need to improve contract management practices for the supply of goods and services. Wastewater staff participating in contracts are not fully knowledgeable of contract terms and conditions. Some contracts also lack a contract lead who would take overall responsibility for managing contracts and coordinating contract management activities such as monitoring contractor performance.

Staff training is an important issue that requires evaluation

While we have identified issues relating to non compliance with City policies, it is important that in the evaluation of the reasons for non compliance the issue of staff training is addressed.

Toronto Water's wastewater operations are substantially in compliance with Provincial requirements

Toronto Water's wastewater operations are regularly reviewed by the Ministry of the Environment for compliance with legislative requirements. Toronto Water's wastewater operations are substantially in compliance with provincial requirements. Wastewater staff have been advised of certain issues, primarily of an administrative nature, and work with the Ministry to address all issues identified.

Energy consumption should be identified in capital budgeting decisions

Finally, Toronto Water's water and wastewater treatment plants incur significant energy costs. Capital budgeting decisions that consider energy consumption could help the City reduce costs and meet its greenhouse gas emission targets.

Details on each one of these issues are provided in the balance of the report.

BACKGROUND

Toronto Water treats wastewater in four treatment plants

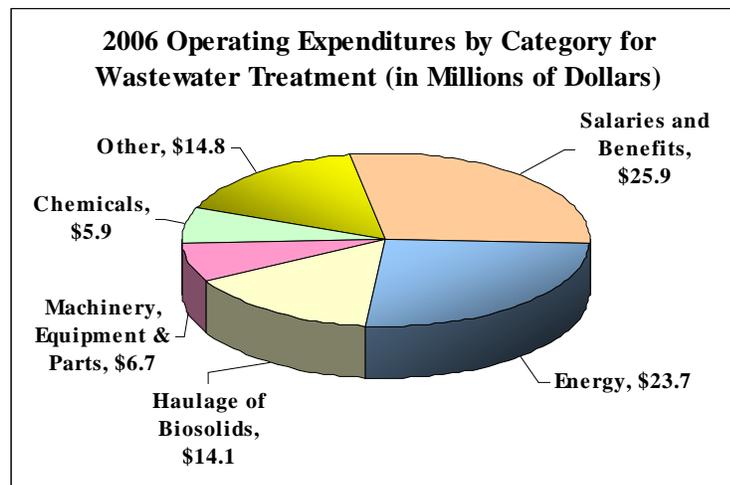
Toronto Water is responsible for supplying Toronto's drinking water and for collecting and treating the City's wastewater, from both sanitary sewage and stormwater. Revenues are derived from user fees charged for water consumption and sewage treatment, rather than through tax assessment.

The Wastewater Treatment section of Toronto Water operates four wastewater treatment plants, which treated approximately 438 million cubic metres of wastewater and generated over 53,000 dry tonnes of wastewater biosolids in 2006. Biosolids are the solid organic material left after solids are separated from liquids in the wastewater treatment process.

The four plants cost \$91 million to operate in 2006

In 2006, the four wastewater treatment plants incurred gross expenditures totalling \$91 million of which in-house staff costs accounted for \$26 million or approximately 28 per cent of the plant operating costs. Other major operating costs include energy usage and the processing and disposal of biosolids. Figure 1 below provides 2006 operating expenditures by category for the wastewater treatment program.

Figure 1



AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

What Were the Objectives of this Audit?

We reviewed economy and efficiency of certain aspects of the wastewater program

The objective of this audit was to assess whether the City's wastewater treatment program is being managed economically, efficiently and in compliance with City policies and legislative requirements. Due to the scope of the work involved, this review was divided into two phases.

What did Phase One Include?

Phase One reported to Audit Committee in September 2007

Phase One reviewed controls over payroll processing, overtime and attendance management and maintenance activities at the wastewater plants.

What did Phase Two Include?

Phase Two focused on controls over purchases, payments and contract management for operating expenditures. In addition, we reviewed controls over inventory and monitoring of energy usage in the wastewater plants.

How Did We Conduct this Audit?

How We Did the Audit

Our audit methodology included the following:

- review of Province of Ontario statutes, regulations, guidelines and procedures relating to water management;
- review of City of Toronto by-laws, directives, policies, procedures and current divisional practices;
- interviews with staff of the Toronto Water Division and other City divisions;
- review of documents, records and management reports;

- evaluation of management controls;
- review of certificates of approval and inspection reports issued by the Ministry of the Environment for two wastewater treatment plants;
- observation of processes and procedures at Ashbridges Bay and Highland Creek Treatment Plants;
- review of Council and Committee minutes;
- review of two audit reports issued by the City of Toronto's Internal Audit Division (Purchasing Cards and DPOs);
- review and consideration of allegations made to the Fraud and Waste Hotline Program pertaining to the wastewater section of Toronto Water Division; and
- review of audit reports of other local governments in Canada and the United States.

We reviewed the audit work of a number of other organizations

We also reviewed related audit work conducted by the following audit agencies:

- Office of the Provincial Auditor of Saskatchewan;
- United States Government Accountability Office; and
- Australian National Audit Office.

This audit was conducted in accordance with generally accepted government auditing standards

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

AUDIT RESULTS - WHAT DID WE FIND?

A. CITY PURCHASING POLICIES ARE NOT BEING FOLLOWED

A.1. Use of Departmental Purchase Orders does not Always Comply with City Purchasing Policies

Four wastewater plants spent \$9 million using DPOs

DPOs are used to purchase a significant amount of goods and services. In 2006, the Toronto Water Division spent \$20 million using DPOs, of which \$9 million was spent by the four wastewater plants. For the Toronto Water Division, spending on DPOs has increased by \$9 million or 78 per cent since 2003.

The wastewater plants are not always complying with corporate policy on use of DPOs

The wastewater plants are not always complying with the City's purchasing policies in using DPOs.

City purchasing policies require that DPOs are only issued for one-time purchases up to \$7,500. Where the amount being purchased using a DPO is greater than \$3,000, three quotes must be obtained. For repetitive purchases from the same supplier or purchases exceeding \$7,500, City contracts or purchase orders should be issued by the Purchasing and Materials Management Division after a formal competitive process.

To address operational requirements, an increase in the DPO limit to \$50,000 has been approved and is in the process of being rolled out to Divisions. Under the new DPO procedures, documentation will be required to be kept on file.

The City Manager has previously expressed concerns relating to non compliance with policy

In January 2005, the City Manager issued a memo to senior management regarding compliance with City purchasing policies for DPOs. Staff in the Toronto Water Division, as well as other City divisions are not always complying with policies despite direction from the City Manager, recommendations in previous audit reports and reports from the City's Internal Audit Division.

We identified a number of regularly required or anticipated goods and services purchased from the same vendor such as electrical supplies and industrial hardware. For example, approximately \$200,000 was paid to one vendor for industrial hardware in 2006 using only DPOs.

City policy also requires that DPOs are prepared prior to

ordering goods or services. We noted that DPOs were sometimes prepared after the goods or services were received and invoiced. Also, for two out of the ten DPOs reviewed that required three quotes, there was no evidence that three quotes were obtained as required by policy.

Purchases are being split to avoid issuing purchase orders

Finally, we noted instances where purchases were split to keep the purchase below the \$7,500 limit for a departmental purchase order or below the \$3,000 limit for three quotes. In one instance, a purchase of \$8,881 was split into two DPOs to keep the purchases below \$7,500 to avoid issuing a purchase order and undertaking a formal competitive process. In another instance, a purchase for urgent pump repairs was split into three orders to avoid obtaining three quotes. Without any competitive process, there is no assurance that the city paid the best price for goods and services.

Recommendation:

- 1. The General Manager, Toronto Water Division, take appropriate steps to ensure compliance with the City's purchasing policies such as:**
 - a. discontinue the practice of using DPOs for repetitive purchases where the use of a blanket contract would be more appropriate;**
 - b. ensure that DPOs are prepared prior to ordering goods and services;**
 - c. ensure that three quotes are obtained where required;**
 - d. discontinue the practice of splitting DPOs to keep the purchase amount below the maximum of \$7,500 for a DPO or below the \$3,000 limit for three quotes; and**
 - e. take steps to identify areas of continued non compliance and impose appropriate discipline for non compliance with City policies.**

A.2. Justification for Sole Source Purchases is not Always Documented

Contrary to policy, purchases are being made without obtaining competitive prices

Approximately 45 per cent or 18 out of 40 DPOs reviewed were for sole source or non-competitive purchases. The City's sole source procedure allows non-competitive purchases in emergencies and when the required goods and services are available from only one supplier. Sole source purchases up to \$7,500 can be processed with a DPO. For purchases above \$7,500, a sole source purchase requisition must be prepared, reviewed by Purchasing and Materials Management staff and approved by the Toronto Water General Manager. The requisition must provide a detailed explanation for the sole source purchase.

According to plant staff, approximately 45 per cent of sole source purchases were due to emergencies. However, of the 18 sole source purchases reviewed, five were non-emergency purchases where quotes were not obtained and written evidence was not available to substantiate the need to sole source the purchase. Consequently, we were unable to determine that the required goods and services needed to be sole sourced.

We also noted a number of sole source purchases were from a supplier that was used frequently to purchase goods and services for the Division. Again, there was no documentation to support that a sole source purchase was necessary. Without competitive procurement, the best price may not have been obtained for these goods and services.

Recommendation:

- 2. The General Manager, Toronto Water Division, ensure that reasons for not obtaining competitive quotes are documented on departmental purchase orders and that written evidence and approval is available to substantiate the need to sole source the purchase.**

B. PROCUREMENT PLANNING

B.1. More Blanket Contracts are Needed

The lack of blanket contracts was given by wastewater staff as the primary reason for using DPOs. More blanket contracts would reduce the use of DPOs and staff time spent on purchasing.

Use of blanket contracts instead of DPOs could realize significant savings

Establishing contracts rather than using DPOs will also save the City significant dollars. Based on an analysis of repetitive purchases for the Toronto Water Division, we estimate that approximately 40 per cent of the dollar value of DPOs could be purchased through contracts. The balance of purchases are one-time or emergencies where using DPOs is necessary to meet operational requirements. According to Purchasing and Materials Management staff, discounts of approximately 15 per cent were recently achieved on new blanket contracts. If an average discount of 15 per cent was applied to the \$9 million spent on DPOs in 2006 for the wastewater plants, and we assume 40 per cent of the purchases were repetitive in nature, the City would have saved approximately \$540,000.

Staff training and operational efficiencies will allow more blanket contracts to be created. Once done, the need for additional staff can be assessed

Management recognizes the need for more blanket contracts and efforts are being made to identify frequently used services and develop blanket contracts. We noted that progress has been made on using more blanket contracts. However, according to staff in Purchasing and Materials Management and Policy, Planning, Finance and Administration Divisions, insufficient resources are currently being assigned to developing blanket contracts. For example, only one purchasing staff in Policy, Planning, Finance and Administration Division was assigned to developing blanket contracts for all of Toronto Water. Consequently, contracts cannot be arranged on a timely basis leading divisional staff to resort to the use of DPOs. In addition, detailed specifications required for purchasing documents are normally provided by operational staff. However, wastewater staff have not always been able to provide the detailed information necessary to expand the use of blanket contracts.

Recommendation:

- 3. The General Manager, Toronto Water Division, in consultation with the Director, Purchasing and Materials Management and the Executive Director, Policy, Planning, Finance and Administration, devise a procurement plan to ensure blanket contracts are issued for repetitive purchases.**

B.2. Communication with the Purchasing and Materials Management Division

In October 2006, the Purchasing and Materials Management Division requested that all City divisions provide them with their procurement needs for 2007 so that purchasing staff could better plan and schedule their resources. While the Toronto Water Division provided purchasing staff with priorities and deadlines for construction contracts and requests for proposal for capital projects, they did not provide their procurement needs for operating expenditures.

Toronto Water and procurement staff are working together to reduce purchasing delays

Wastewater staff have also indicated that Purchasing and Materials Management staff do not process their purchase requests on a timely basis. According to the purchasing staff and our general observations, wastewater staff sometimes do not allow enough lead time when renewing blanket contracts. Purchasing and Materials Management staff are currently developing information to allow wastewater staff to better estimate lead times for setting up blanket contracts.

Proper procurement planning that communicates the nature and expected timing of procurement needs to purchasing staff on a timely basis would allow Purchasing and Materials Management staff to better meet division timelines.

Recommendations:

- 4. The General Manager, Toronto Water Division communicate procurement needs of the wastewater plants to the Purchasing and Materials Management Division on a timely basis. The procurement needs should include priorities and expected timelines for the completion of purchase requests.**

- 5. The General Manager, Toronto Water Division and Director, Purchasing and Materials Management, monitor the completion of purchase requests and follow up the reasons for delays in meeting established deadlines.**

B.3. Centralize Purchasing for Common Goods

Common purchases need to be grouped together to receive the best pricing

Currently, frontline staff in the wastewater plants do their own purchasing for their own work areas. This is because the Works Best Practices program delegated purchasing to work area staff and eliminated a central stores function. Certain work areas purchase similar items such as nuts and bolts, engine oil and safety equipment. Although some purchases for parts and equipment are unique to specific work areas, common goods used by all work areas could be purchased centrally. This would reduce staff time in processing purchases and achieve better prices through bulk purchases.

Recommendation:

- 6. The General Manager, Toronto Water Division, review the feasibility of centralizing purchasing for common goods at the wastewater plants.**

C. CONTRACT MANAGEMENT

C.1. Clearly Define and Assign Contract Administration Roles and Responsibilities

Many significant contracts do not have one individual responsible for ensuring terms and conditions are met

Many contracts do not have a contract lead that takes overall responsibility for managing a contract. Currently, Team Coordinators in the wastewater plants make purchases based on contracts for goods and services but do not perform the broader role of managing key contract management activities such as monitoring contractor performance and expenditures. Team Coordinators, responsible for approving payments on contracts, were not aware of all contract terms and conditions such as unit prices and health and safety requirements. They relied on other staff to accurately process contractor payments and ensure that vendors met contract provisions.

Lack of understanding of roles leads to gaps in contract management

We had difficulty identifying staff responsible for contracts. Generally, the contact person listed on the contract was only responsible for developing the contract and was not involved in administering the contract. In addition, wastewater staff were not always aware of the contract lead, even in cases where an individual was assigned.

Wastewater staff are not always clear what role other City staff have in managing contracts. For example, one Team Coordinator assumed that purchasing staff had ensured the product met specifications in the contract. However, this is the responsibility of the client division.

We also had difficulty in locating all relevant documents such as the Workplace Safety and Insurance Board clearance certificates. The purpose of a clearance certificate is to provide financial protection to organizations who hire contractors and subcontractors to perform work.

In February 2007, to assist staff in better managing their contracts, the City Manager directed that all City divisions use a template available on the City's intranet site to summarize key contract terms and conditions for all future contracts. Completing this template would enable wastewater staff to effectively carry out their contract management responsibilities.

Although, wastewater staff have received training in purchasing, they need additional training in contract management to fulfill their contract management responsibilities.

Recommendations:

- 7. The General Manager, Toronto Water Division, assign a contract lead to all contracts and ensure that all staff participating in contracts are aware of the relevant contract provisions and their responsibilities in managing the contract. These responsibilities include:**
 - a. ensuring that goods delivered and payments comply with contract provisions; and**
 - b. obtaining and retaining relevant contract documents.**

- 8. The General Manager, Toronto Water Division, ensure that all staff involved in managing and developing contracts receive appropriate training to effectively carry out their responsibilities.**

C.2. Vendor Performance Should be Monitored and Documented

The formal evaluation of contractor performance is not being conducted

There is no formal evaluation on the performance of contractors. Team Coordinators were not aware of the need to evaluate contractors and maintain records of contractor performance. In addition, they were not aware of anyone who was responsible for collecting information on contractor performance issues. According to the City's procurement process, divisions should maintain records of vendor performance on all contracts. Vendor performance records can be used in addressing problems with vendors during the contract and at its conclusion to ensure future contracts are not awarded to vendors with poor performance records.

Recommendation:

- 9. The General Manager, Toronto Water Division, require that supervisory staff with contract management responsibilities evaluate and document vendor performance both during a contract and at its conclusion.**

D. PURCHASING PAYMENT PROCESSES REQUIRE IMPROVEMENT

In 2004, the Toronto Water Division was one of the first City divisions to implement a payment process called "the three way match". In this process the financial system electronically matches a vendor's invoice with the purchasing and receipt documents before payment is made by accounts payable. The process promotes the timely payment of invoices and eliminates the need to send the vendor invoices to the divisions for approval.

D.1. Payment Review Process Should be Improved

The payment review process in the wastewater plants requires improvement to ensure that the City pays the best price for goods and services received.

Staff are approving DPOs without reviewing relevant supporting documents

A primary control in the three way match payment process is a requirement that supervisory staff approve the purchase order in the financial system. Supervisory staff are required to review information recorded in the financial system such as evidence that three quotes were obtained or the reason for sole source purchases. Because information such as vendor prices relating to quotes was often not recorded in the financial system, supervisory staff would have difficulty in determining the appropriateness of the services rendered or goods ordered. In such circumstances, staff approving the purchase orders need to satisfy themselves that three quotes were obtained for DPOs greater than \$3,000 and written evidence to confirm non-emergency sole source purchases.

Closer scrutiny of invoices is required for more complex contracts or purchases

In general, supervisory staff do not receive and review vendor invoices. Under the three way match process, accurate payment of invoices depends on the electronic matching of goods received and approval of the appropriate purchasing document. However, where contracts have complex terms and conditions, additional checking of invoices may be required to ensure that the amounts billed agree to contract terms. Currently, management conducts detailed checking of invoices for biosolids contracts and has regularly identified and corrected significant invoice errors. Similar detailed checking on other vendor invoices could identify previously undetected errors.

We noted that Team Coordinators do not always review receiving documents for reasonableness to ensure that the City is paying for the services rendered or quantity received according to contract terms.

Overpayments have occurred on certain contracts

We identified one contract where travel charges have been significantly overcharged, (\$18,000 on a \$220,000 contract) for the last three years. The Team Coordinator was not aware of the contract terms. In fact, none of the supervisors were aware of contract terms when we questioned the validity of charges on certain invoices. Management is currently reviewing these charges with the vendor, with the objective to recovering any monies due.

Some invoices don't provide enough detail to ensure the City is being charged the correct amounts

Invoices and supporting documents did not always provide sufficient detail such as labour rates and specific equipment used. Consequently, it was not possible to determine whether the amounts billed are accurate and in compliance with the contract terms. In addition, we identified several contracts where the contract and bid documents did not specify what detailed information the vendor should include on invoices to support charges.

Recommendations:

- 10. The General Manager, Toronto Water Division, ensure that staff responsible for approving purchases are aware of their responsibilities to determine the appropriateness of the services rendered or goods ordered by reviewing appropriate supporting documentation.**
- 11. The General Manager, Toronto Water Division, require that detailed checking of invoices and receiving documents be performed for high value and complex contracts to ensure that amounts billed to the City agree with the contract terms.**
- 12. The Deputy City Manager and Chief Financial Officer ensure that contract and bid documents require that vendors provide sufficient detail on invoices to support charges billed to the City.**

D.2. Lack of Segregation of Duties over Purchasing

Some staff are responsible for a combination of incompatible functions. Controls in these circumstances require strengthening

Generally, there is not a segregation of duties between ordering and receiving goods and services in the wastewater plants. In addition, these same staff create the DPO and record the receipt of goods in the accounting system. There are not adequate compensating supervisory controls. As a result, staff with conflicting duties could process transactions such that the City pays for goods or services not actually received.

Recommendation:

- 13. The General Manager, Toronto Water Division, ensure that there is a segregation of duties between ordering, receiving and the recording of goods and services. Where feasible, the same individual should not both order and receive goods and record these transactions in the accounting system.**

D.3. Purchasing Records Should be Consistently Filed

Purchasing records are not consistently filed

There is no consistency in record keeping in the wastewater plants. Staff maintain purchasing records in various locations, including their own desks, which makes locating documents difficult. Documents would be easier to find if they were filed centrally in each work area or at a central location in each plant.

Recommendation:

- 14. The General Manager, Toronto Water Division, develop a consistent approach to maintaining purchasing records in the wastewater plants such as centrally in each work area.**

D.4. Delays in Processing Purchasing Documents

Failure to input all required information results in some delays in making payments to vendors

Wastewater staff are not always processing purchasing documents promptly and accurately. As a result, payment of invoices may be delayed and purchase orders may not be approved by supervisors on a timely basis.

Using the three way match process, accounts payable staff pay invoices when a vendor's invoice is matched with the purchasing and goods receipt documents recorded on the system by divisions. When these documents do not match, accounts payable staff do not pay the invoice. Electronic matching of documents should result in more timely payment of invoices.

According to a report provided by the Policy, Planning, Finance and Administration Division, as of August 30, 2007, \$705,490 in purchases billed on 172 invoices were not processed for payment by accounts payable because

purchasing documents did not match or were in dispute. The most frequent reason was that wastewater staff order and receive goods but do not create the purchasing document in the accounting system. As a result, accounts payable cannot pay vendor invoices. This is a greater problem in the wastewater plant where frontline staff, rather than administrative staff, process most of the purchases.

Technical staff are required to perform many purchasing /accounting functions

The Works Best Practices program delegated purchasing to the frontline staff such as millwrights and electricians in the wastewater plants. On average, these staff spend a minimum of one hour per day on purchasing. However, their core duties relate to repairing equipment to keep the wastewater plants operating effectively. Therefore, their administrative duties have received less attention.

Recommendation:

- 15. The General Manager, Toronto Water Division, in consultation with the Deputy City Manager and Chief Financial Officer and the Executive Director, Policy, Planning, Finance and Administration, assess whether the centralized inputting of departmental purchase orders by administrative staff in the wastewater plants would improve the efficiency and effectiveness for processing of purchasing documents.**

E. CONTROLS OVER EQUIPMENT AND PARTS INVENTORY ARE INADEQUATE

E.1. Lack of Controls over Inventory

Controls over equipment and parts inventory are inadequate

Currently, internal controls over equipment and parts inventory in the wastewater plants are inadequate. There is no inventory list of materials, equipment and tools at both the Ashbridges and Highland Creek Treatment Plants. In addition, inventory counts are not conducted and obsolete equipment may not be removed from inventory. As a result, the plants do not know the value or amount of inventory on hand.

Inventory levels and usage need to be assessed to determine the appropriate level of control required

As a first step to determining the amount of effort appropriate to control inventory, management needs to determine the actual level of inventory, the usage of that inventory and the risk of loss for the inventory. Once this is done, decisions can be made as to the appropriate level of control over these City assets.

The Works Best Practices Program eliminated stores staff who ordered supplies, maintained inventory records on a computer system, and conducted inventory counts. Ordering materials and supplies and maintaining inventory were delegated to frontline staff who now order parts as needed based on a visual count of parts and past experience.

Inventory is located in various work areas throughout the plants and is generally secured in locked cages. Staff in each work area have access to inventory and remove inventory as required to perform operational duties. Some inventory items, however, such as safety devices which are not specific to one work area and used infrequently, could be stored centrally for better control in a secure location.

At Highland Creek Treatment Plant, some inventory is also located centrally with a storekeeper and staff sign authorization slips to remove inventory. However, the authorization slips provide little control as they are not reconciled to the inventory on hand and staff can remove goods when the storekeeper is absent.

A Corporate Warehouse/Stores Rationalization Project is underway

The Purchasing and Materials Management Division is implementing a corporate approach to materials management of the City's warehouses called the "Corporate Warehouse/Stores Rationalization Project". This is now being done at locations with significant levels of inventory. This project includes an assessment of inventory controls at various City warehouses and the development of a common computerized information system for inventory. City divisions remain responsible for performing inventory control functions such as receiving, stocking, issuing inventory and conducting inventory counts. Wastewater staff require assistance in assessing and implementing inventory controls that are appropriate to their operations. Therefore, we suggest that any improvements put in place as a result of the Corporate Warehouse /Stores Rationalization Project be

considered for implementation in the wastewater treatment plants.

Recommendations:

- 16. The General Manager, Toronto Water Division, perform a risk analysis on inventory at the wastewater treatment plants. Such analysis to include determining the levels of inventory, annual spending on inventory items and risk of loss for these items.**

- 17. The General Manager, Toronto Water Division, in consultation with the Director, Purchasing and Materials Management Division monitor changes made as part of the of the Stores/Warehouse Rationalization Project and if appropriate implement relevant changes to the Stores function in the wastewater treatment plants. Subject to the results of the inventory risk analysis, the General Manager, Toronto Water Division, consider inventory controls such as:**
 - a. maintaining inventory of significant value on a computerized information system;**

 - b. conducting periodic physical counts of inventory by staff independent of inventory functions;**

 - c. valuing and recording of inventory items of significant value on the City's accounting records; and**

 - d. identifying and removal of obsolete inventory.**

COMPLIANCE WITH LEGISLATIVE REQUIREMENTS

F.1. Toronto Wastewater Plants Substantially Comply with Legislative Requirements

Wastewater plants are inspected by the Ministry of the Environment

Toronto Water's wastewater operations are governed by various legislation. The Ministry of the Environment conducts inspections to ensure the City is in compliance with legislation. We reviewed numerous reports from the Ministry of the Environment relating to the results of their inspections and found that, while there were issues noted, these were primarily of an administrative nature. For example, one inspection cited that there were no records available relating to maintenance activities on waste gas burners for a nine month period. In all cases, wastewater staff are working with the Ministry of the Environment to ensure the necessary steps are taken to correct the underlying issues.

G. ENERGY

G.1. Energy Consumption Should be a Factor in Capital Decision Making

Toronto Water is a significant consumer of energy

Toronto Water's water and wastewater treatment plants require a significant amount of energy. For example, Ashbridges Bay Treatment Plant spent \$12.4 million on energy costs in 2006 and is the City's largest user of electricity. To improve energy conservation, each wastewater plant is monitoring energy costs and consumption and is reviewing capital expenditure options to upgrade equipment and processes and reduce energy usage.

Energy consumption is only identified for energy retrofit capital projects

According to the City's 2008 capital budget guidelines, only business cases for energy retrofits require the submission of energy consumption data. Financial Planning staff confirmed that energy consumption is not currently a factor in capital decision making, other than energy retrofits. Capital decisions that consider energy consumption could help the City in reducing its energy usage and in meeting its greenhouse gas emission reduction targets.

Recommendation:

- 18. The Deputy City Manager and Chief Financial Officer require estimated energy consumption data in business case information for capital budget submissions that impact ongoing energy usage.**

CONCLUSION

This report presents the results of Phase Two of our review of Toronto Water's wastewater treatment program. Phase Two focused on controls over purchases and payment processing, inventory and contract management. Phase One, which was previously reported to Audit Committee, addressed controls over payroll processing, overtime and attendance management, as well as the use of technology in managing maintenance activities.

We have identified supervisory and financial control weaknesses in processing payments, managing contracts and maintaining inventory. We also found that the wastewater plants have not complied with City purchasing policies regarding DPOs, which are intended for one time and emergency purchases. Implementing blanket contracts for frequently used goods and services would achieve significant cost savings. The City is increasing DPO limits and this should make it easier for City divisions to comply with related policies.

Addressing the recommendations in this report will improve financial controls and contract management practices, enhance the efficient use of staff resources and increase the use of competitive procurement in wastewater operations.