

**Auditor General's Office
2008 Budget**

November 2, 2007

 **TORONTO** Auditor General's Office

Jeffrey Griffiths, C.A., C.F.E.
Auditor General
City of Toronto

TABLE OF CONTENTS

THE AUDIT FRAMEWORK AT THE CITY OF TORONTO	1
The Auditor General’s Office	1
The Internal Audit Division – City Manager’s Office	2
External Annual Financial Audit.....	2
THE AUDITOR GENERAL’S OFFICE	3
Responsibilities of the Auditor General.....	3
Professional Audit Standards	4
THE AUDITOR GENERAL’S OFFICE – 2008 BUDGET REQUEST	5
2008 Budget Request	5
External Audit Fees.....	6
Benefits of an Effective Audit Process	7
The Auditor General’s Annual Work Plan.....	7
The Impact of the City of Toronto Act	8
The Role of the Ombudsman Under the City of Toronto Act.....	9
The Benchmarking of Audit Costs – Comparisons With Other Municipalities	9
Additional Workload Pressures.....	11
Summary	12

ATTACHMENTS

Auditor General’s Office – Organizational Chart and Workforce as of December 31, 2007 and 2008.....	Attachment 1
National Association of Local Government Auditors – External Quality Control Review of the Auditor General’s Office, Toronto, ON.....	Attachment 2
National Association of Local Government Auditors – Companion Letter February 23, 2006	Attachment 3

THE AUDIT FRAMEWORK AT THE CITY OF TORONTO

In May 2002, City Council approved an independent Auditor General's Office for the City of Toronto in conjunction with the implementation of a new audit framework. The *City of Toronto Act, 2006* has subsequently formalized the establishment of the Auditor General. Section 177 of the Act requires that "The City shall appoint an Auditor General".

The 2002 audit framework established three levels of audit services for the City of Toronto. This framework is consistent with best practices in most major Cities.

- (1) The Auditor General's Office was created in order to report directly to and provide assurance strictly for City Council. The *City of Toronto Act, 2006* has not changed this requirement.
- (2) A separate Internal Audit Division reporting to the City manager was established to provide assurance for the City's Executive Management Team. While the establishment of an Internal Audit function is not a legislative requirement, it does represent best practice and is consistent with practices in other large government organizations.
- (3) Finally, as required by the *City of Toronto Act, 2006*, an external auditor is appointed by City Council to perform the annual statutory audit of the City's financial statements and provide an opinion on the fairness of the information presented in these financial statements.

The Auditor General's Office

City of Toronto By-law No. 1076-2002 enacted in 2002, and set out in Chapter 169 of the Municipal Code, established the Auditor General's Office, duties and responsibilities. As indicated above, the new City of Toronto Act mandates the appointment of an Auditor General who reports to City Council. Under Section 178 (1) of the *Act* "the Auditor General is responsible for assisting City Council in holding itself and city administrators accountable for the

quality of stewardship over public funds and for achievement of value for money in city operations.”

The Internal Audit Division – City Manager’s Office

The Internal Audit Division reports to the City Manager and is responsible for providing internal audit services and support to senior management in the City. The internal audit function provides impartial and objective assurance, consulting services designed to improve the administration of municipal operations and promotes compliance with City policies and procedures.

External Annual Financial Audit

Under Section 139 of the *City of Toronto Act, 2006*, the City is required to appoint an auditor licensed under the Public Accounting Act 2004, who is responsible for annually auditing the accounts and transactions of the City and its local boards and expressing an opinion on the financial statements of these bodies based on the audit. Also in accordance with the Act, the auditor shall not be appointed for a term exceeding five years. In addition, the *Act* requires that the auditor shall not be a City employee or an employee of a local board of the City. The auditor reports to City Council.

Ernst & Young, LLP an external public accounting firm, is responsible for the annual statutory audit of the City’s financial statements up to and including December 2007, under a five-year contract approved by City Council in 2003. The Auditor General is responsible for issuing the request for proposal to secure the external audit services required by the City and maintains an oversight role for these statutory audits.

Subject to any Council approved extensions to Ernst & Young’s contract, a request for proposal for audit services will be issued late in 2007 to award the contract for auditing the financial statements of the City for the five year period commencing with December 31, 2008.

THE AUDITOR GENERAL' S OFFICE

As outlined under Section 178 of the *City of Toronto Act, 2006*, “The Auditor General is responsible for assisting city council in holding itself and its administrators accountable for the quality of stewardship over public funds and for the achievement of value for money in city operations.”

The audit process is an independent, objective assurance activity designed to add value and improve an organization’s operations. The audit process assists an organization in accomplishing this objective by bringing a systematic, disciplined approach in evaluating and improving the effectiveness of risk management, control and governance processes.

Responsibilities of the Auditor General

In carrying out its audit activities, the Auditor General’s Office is independent of management, and has the authority to conduct financial, operational, compliance, information systems, forensic and other special reviews of City Divisions, and those local boards provided for under the *City of Toronto Act, 2006* and such City-controlled corporations and grant recipients as City Council may specify. The Auditor General reports to Council through the Audit Committee.

Specific responsibilities of the Auditor General include:

- audit projects identified by the Auditor General included in the annual work plan and identified through the Auditor General’s annual risk assessment;
- the conduct of forensic investigations including those involving suspected fraudulent activities;
- providing assurance that the information technology infrastructure contains adequate controls and security including business continuity (emergency) planning;
- conducting special assignments identified by the Auditor General, or approved by a two-thirds majority resolution of Council;

- overseeing the work and the contract of the external auditors performing financial statement audits; and
- managing the Fraud and Waste Hotline Program, including the investigation of complaints, as well as the referral of certain concerns and issues to divisional management and the Internal Audit Division.

Audit work at the City requires coordination with the City Manager's Internal Audit Division, as well as similar audit groups at the Toronto Transit Commission and the Toronto Police Service. The Auditor General meets with each of these groups on a regular basis in order to ensure that he is aware of any audit concerns and to ensure that there is no duplication of audit work.

The Auditor General also meets on a regular basis with both the external auditor and the City's Integrity Commissioner to discuss any issues of mutual concern.

Professional Audit Standards

The Auditor General's Office conducts its audit work in accordance with generally accepted Government Auditing Standards. Audits are conducted in accordance with these standards, which relate to independence, objectivity, professional proficiency, scope and performance of work and departmental management. Staff are also bound by the standards and ethics of their respective professional organizations, which include the Institute of Chartered Accountants of Ontario, the Certified General Accountants Association, the Society of Management Accountants, the Information Systems Audit and Control Association, the Institute of Certified Fraud Examiners and the Canadian Environmental Auditing Association.

One requirement of Government Auditing Standards is that audit organizations undergo an external peer review at least once every three years. The objective of a peer review is to determine whether an audit organization's internal quality control system is in place and operating effectively. A peer review provides assurance that established policies and procedures and applicable auditing standards are being followed.

The Auditor General's Office underwent its first peer review during 2006. No other audit office in Canada has undergone such a process. Two reports were issued by representatives from the National Association of Local Government Auditors and are attached to this report as Attachments 2 and 3.

All non-administrative members of the Auditor General's Office have at least one professional designation. Details of staff qualifications are provided on the following web site http://www.toronto.ca/audit/about_audit.htm#staffing.

THE AUDITOR GENERAL'S OFFICE – 2008 BUDGET REQUEST

Details relating to the 2008 budget request for the Auditor General's Office are as follows:

Table 1

	2008 Budget Request	2007 Approved Budget	2007 Projected Actual
Salaries	2,984,294	2,863,312	2,854,471
Employee Benefits	705,937	655,798	639,213
External Audit Fees	320,755	320,755	320,755
Services, Materials and Supplies	113,613	124,530	82,869
Interdepartmental Charges	22,722	24,006	23,045
Total	4,147,321	3,988,401	3,920,353

2008 Budget Request

The amount of **\$4,147,321** is the Auditor General's budget request for 2008 and represents the Auditor General's detailed analysis of audit resource requirements including the operation of the Fraud and Waste Hotline Program for the City. This amount represents an increase of 4.0 per cent over last year's approved budget and accommodates salary increases and other corporate economic factor increases.

The majority of the Auditor General's 2008 budget request consists of salaries and benefits. In fact, out of a budget of \$4,147,321 an amount of \$3,690,231 or 89 per cent consists of salaries and benefits.

Further, the Auditor General has no control over the \$320,755 in external audit fees paid to the external audit firm as the amount is predetermined based on a five year contract. If this amount is excluded from the budget of the Auditor General's Office, the actual percentage of the salaries and benefits to the total budget is in the range of 96 per cent.

The Auditor General's Office currently operates with a staff of 26 professionals and 3 administrative staff. We are not requesting any additional staff in 2008. As of December 31, 2007, the Auditor General's Office is operating one position short of a full staff complement. The vacant position has not been filled in order to comply with the current cost containment initiative.

In order to reduce the budget to last year's level of \$3,988,401 an amount of \$158,920 would have to be deducted from the 2008 budget request. Such a reduction can only be accommodated by reducing the level of staff by two.

External Audit Fees

The current 5 year contract for external audit services is ending with the audit of the December 31, 2007 financial statements. The Treasurer however, is seeking Council approval to extend the current contract for a further two years. The reasons for the proposed extension are provided in a report to the November 16, 2007 meeting of the Audit Committee. If this extension is not approved the Auditor General will issue a Request for Proposal for audit services for a five year period commencing for the year ending December 31, 2008.

The fee for the 2008 external audit will likely increase as a result of either a new five year contract or a negotiation of the extension of the current contract. The extent of any increase is unknown at the present time. On the advice of the Deputy City Manager and Chief Financial

Officer the Auditor General's budget for audit fees for 2008 is provided for at the same amount as in prior years. The Auditor General's budget will be adjusted once the extent of any fee increase has been determined.

Benefits of an Effective Audit Process

An effective audit process can result in a significant payback to the City in terms of:

- increased revenues;
- reduced costs;
- improved internal controls;
- operational efficiencies; and
- enhanced protection of City assets.

The costs savings generated by the Auditor General's Office since amalgamation, while difficult to quantify precisely, have been significant and far outweigh the costs to operate the office. Many of the savings generated are not one-time savings as in many cases they represent ongoing annual savings.

In a report to Audit Committee dated March 22, 2007 entitled "Auditor General's Audit Reports - Benefits to the City of Toronto – Annual Update", it was reported to Audit Committee that the actual potential net savings (after accounting for the annual budgets of the Office) for the period 2002 to 2006 were in the range of \$56 million. At the request of the Audit Committee, this report will be updated and tabled with the Committee during the first quarter of 2008.

The Auditor General's Annual Work Plan

The 2008 annual audit work plan of the Auditor General is in the final stages of development and will be presented to the next Audit Committee. Based on discussions with the Toronto Police Service and the Toronto Police Services Board, certain audit work required by both the Chief of Police and the Police Services Board will be a priority and as such will be included in the work plan.

The Impact of the City of Toronto Act

The City of Toronto Act has had an impact on the Auditor General's ability to audit certain of the City's local boards. Prior to the Act, the Auditor General had access to all records at each of the City's local boards and was able to conduct audit work based on his analysis of risk.

The *City of Toronto Act, 2006* states, in Section 178 (3) under Powers and Duties of the Auditor General's Office, that "the Auditor General may exercise the powers and shall perform the duties as may be assigned to him or her by city council in respect of the City, its local boards (restricted definition) and such city controlled corporations and grant recipients as city council may specify." Under the *City of Toronto Act, 2006*, "local boards (restricted definition)" is defined as a local board other than the Toronto Police Services Board, the Toronto Public Library and the Board of Health. In essence, the Auditor General of the City of Toronto, under the new legislation, has no authority to access records or conduct audit work at those "restricted" local boards.

When this provision of the *Act* appeared in the first draft of the *City of Toronto Act, 2006* the City Manager, in consultation with the Auditor General, requested a change to the legislation to amend this section of the *Act* to expand the Auditor General's responsibilities to include those boards specifically excluded. The Ministry of Municipal Affairs and Housing advised that the various ministries responsible for legislation pertaining to the local boards (restricted definition) were not willing to accommodate the change at that time.

The Auditor General met with both the City Manager and the City Solicitor to further address this matter. The City Solicitor has advised that Council may extend the mandate of the Auditor General to include the audits of the "restricted" local boards based upon specific requests of these boards. Under the *City of Toronto Act, 2006* as it now stands, the Auditor General would not have the mandate to independently determine specific audit work at the "restricted" local boards.

City Council subsequently approved that the Auditor General, at his discretion, may undertake financial (excluding attest) compliance and performance audits of the “restricted” local boards upon request by the boards. Further, at the two-year review of the *City of Toronto Act*, amendments to the Act have been proposed to include the “restricted” boards in those entities subject to audit by the Auditor General.

The Role of the Ombudsman Under the *City of Toronto Act, 2006*

Under Section 171 of the *City of Toronto Act, 2006* “the function of the Ombudsman is to investigate any decision or recommendation made or any act done or omitted in the course of the administration of the City, its local boards (restricted definition) and such city-controlled corporations as city council may specify and affecting any person or body of persons in his, her or its personal capacity.”

We have had discussions with the City Manager’s Office, particularly, in the context of the potential overlap of responsibilities as it relates to various complaints received by the Auditor General on the Fraud and Waste Hotline. We will continue these discussions with management but, based on initial discussions, any complaints received on the Fraud and Waste Hotline which are considered “ombudsman related” are currently referred to management by the Auditor General’s Office.

The Benchmarking of Audit Costs – Comparisons With Other Municipalities

The Auditor General’s Office has benchmarked its costs with those of major municipalities across Canada, as well as those of a number of municipalities in the United States. The following comparison of costs with other major municipalities for comparable levels of audit services indicates that, as a percentage of total municipal budgets, the audit costs at the City of Toronto are at the lower end of the scale. As it is not possible to obtain most of the budget numbers for 2008, the majority of costs in this table relate to the 2007 fiscal year.

Table 2

	Municipal Operating Budget (in \$000s)	Audit Costs (in \$000s)	Audit Costs as a % of Municipal Operating Budget
	\$	\$	%
City of Toronto (1) (2008 Estimate)	8,200,000	5,736	0.07
City of Ottawa	2,203,000	1,761	0.08
Calgary	2,378,977	1,671	0.07
Edmonton	1,434,200	1,802	0.13
Winnipeg	1,114,742	1,099	0.10
Los Angeles County	21,044,000	7,900	0.04
Philadelphia	6,868,813	8,150	0.12
Detroit	3,681,508	3,002	0.08
Phoenix	2,238,300	3,239	0.14
San Jose	1,638,054	2,220	0.14

(1) Excludes the Toronto Transit Commission for comparative reasons.

The audit costs for the City of Toronto in the amount of \$5,736,000 included in Table 2 reconciles to the 2008 requested budget as follows:

2008 Requested Budget	\$4,147,321
Less external Audit Fees	(320,755)
Add Internal Audit Functions	<u>1,909,709</u> *
Audit Costs – Table 2	<u>\$5,736,275</u>

* Relates to the Internal Audit functions relating to the City Manager’s Office and the Toronto Police Service.

Of significance in the comparison of audit costs between municipalities is current legislation in Quebec. The Quebec Cities and Towns Act in Section 107.5 requires that, “The budget of the municipality shall include an appropriation to provide for payment of a sum to the chief auditor to cover the expenses relating to the exercise of the chief auditor’s duties.” The amount legislated for audit services in municipalities with a budget in excess of \$1 billion is 0.11 per cent of the total City budget.

If the equivalent percentage of 0.11 per cent was applied to the City of Toronto, the City's total audit budget would be in the range of \$9 million.

The 2008 requested audit budget at the City is as follows:

Auditor General's Office	\$4,147,321
Internal Audit Functions	<u>1,909,709</u>
Total City Wide Audit Budget	<u>\$6,057,030</u>

Using the Quebec model as a guide, it would not be unreasonable to suggest that the audit budget at the City should increase by approximately \$2.9 million. We are not suggesting that such an increase be considered without significant additional deliberation or analysis, nor are we suggesting that these additional resources be exclusively allocated to the Auditor General's Office. For example, any increase to the audit budget at the City should also consider the needs of the Internal Audit Division operating out of the City Manager's Office.

The above analysis does, however, demonstrate that audit resources at the City are not excessive and likely should be increased to a level commensurate with the size of the City. We have recently updated and finalized a long term strategic plan for the Auditor General's Office. This particular plan is addressing the issue of long-term resources along with the frequency of priority audits over the next number of years. It is anticipated that this plan will be issued to the Audit Committee during the first quarter of 2008.

Additional Workload Pressures

An extremely important component of any audit process is the requirement that there be a follow-up of audit recommendations made. There is little benefit to an audit unless recommendations resulting from the audit are implemented. In order to address this issue, we have set up a formal process to follow-up on all previously issued audit reports. The resources devoted to this process have been significant. However, such a process will enable us to ensure that all previously approved recommendations have been implemented.

In addition, the activity relating to the Fraud and Waste Hotline has increased significantly since its inception. It was recognized and acknowledged that during its initial phase, the Hotline could be accommodated with existing resources until the extent of activity was determined. In 2006, with the approval of Council we added one position to deal with the workload created by the Fraud and Waste Hotline. We will continue to monitor the impact of the Fraud and Waste Hotline program on our resources.

Summary

The budget to operate the Auditor General's Office for 2007 is projected to be \$4,147,321. Included in this amount are audit fees paid to an external accounting firm for the annual statutory audit of the financial statements of the City. The Auditor General has no control over these fixed contract fees that are to be renewed for the year ending December 31, 2008.

As indicated previously, 96 per cent of the Auditor General's budget request consists of salaries and wages. In order to reduce the Auditor General's budget to last year's level would require decreasing staff by two persons. In 2006, the Office received Council approval to increase the staff complement in the Auditor General's Office by one person. This person was hired during 2006. The office is currently operating with one vacancy. In order to address cost containment concerns this position remains unfilled.