Attachment 1

2022 | Financial Controls & Governance:
Report on Toronto City Arenas

For the City of Toronto Audit Committee

Welch Risk Advisory LLP®

WELCH LLP

Financial Controls & Governance:

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June 2022

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Executive Summary

- Welch LLP is currently procured to provide the City of Toronto external audit services for 8 City Arenas for the fiscal years 2018 until 2022 (5 years total). Welch was the auditor for these entities for fiscal years 2013 – 2018 as well.

- The audit services contract expires with fiscal 2022 as the final year of audit provided for these entities, after which a new contract for assurance services will be procured. As a result, this is an ideal time to assess the Arena governance and assurance needs.

- The purpose of this report is to analyze the governance and internal control issues encountered during the more recent fiscal periods to find common areas for improvements for the Arenas.

- Analysis shows internal controls weaknesses were identified across most Arenas in the following three areas: (1) cash (AR/AP) processes, (2) Payroll and compensation processes, and (3) Revenues processes and other documentation.

- Qualitative analysis of the internal control weaknesses identified reveals a common theme among most Arena entities: (1) lack of accounting and financial management capacity, (2) dated financial processes, and (3) low utilization of technology.

- Two recommendations are made: (1) further investigate a new governance model that would centralize accounting and financial processes for the Arenas, and (2) consider different types of assurance to complement the governance model selected.

Scope of Report

Background

Welch LLP is currently under contract by the City of Toronto to conduct several financial statement audits for its controlled entities for five fiscal years (2018 – 2022). Of those City entities, there are eight Arenas which are the scope of this report:

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

Welch was the auditor for these entities for fiscal years 2013 – 2018 as well. As independent auditors, we are in a unique position to learn about the circumstances surrounding each of these Arenas, including their financial control environments and overall governance.

Our audit services contract expires in 2023 with the fiscal year ended December 31, 2022 being the final year of audit provided for these entities. After our fiscal 2022 engagement, a new contract for assurance services will be procured. As a result, this is an ideal time to assess the Arena entity governance and assurance needs.

Context

Over the past several years, we have experienced many delays in issuing our audit opinions in a timely fashion. Governing boards and council members have taken note and highlighted that this as an issue that needs to be addressed. The pandemic has exacerbated this situation.

These delays have resulted from the Arenas' limited access to records (dated processes), lack of responsiveness (underutilization of technology), and additional work by us, the auditor (lack of financial accounting capacity on the Arena staff / management level). Lack of timely audited financial information leads to delays in decision-making as Arena boards may not learn about financial issues until well into the following fiscal year. Delayed financial information also presents a challenge to the controllership in consolidating all Arena entities as a part of its public accounts.

To improve the timeliness of financial reports, we believe the underlying issues must first be addressed.

Purpose of Report

The purpose of this report is to look back at the issues we have encountered during our audits over the past several years and present to you our key findings that are common among most or all the Arenas. This will highlight some of the key areas of risk with respect to governance and oversight over the Arenas.

As a part of our annual audit process, Welch provides management letter points and reports any internal control findings to each entity's board at the conclusion of the audit. Management letter points refer to significant control weaknesses that have been communicated to management and we report to the governing board as well.

This purpose of this report is to aggregate these entity-specific findings to identify high-level trends that are present among all the Arenas. This report also makes two recommendations that may further the City's progress in addressing these issues.

Internal Controls Summary

Welch LLP analyzed all the management letter points brought forward to Arena governing boards for audits conducted during the fiscal years 2017, 2018, 2019 and 2020. Below were our findings:

Internal Control Weaknesses – Areas of Concentration

Upon analyzing the areas of internal control weaknesses spanning the audits of fiscal year 2017 – 2020, we can identify some informative trends:

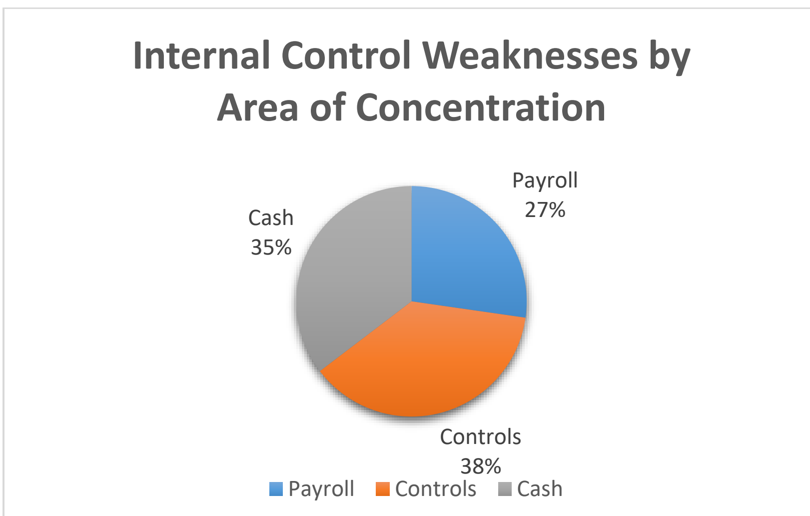
80% of all internal control weaknesses identified relate to three Arenas. Two of the Arenas had zero incidents (i.e. adequate internal controls).

We then classified all internal control weaknesses into the following three categories:

1. Cash / Receivables & Payables Process
2. Payroll and Compensation
3. Revenues and Other Documentation

All these categories are generally considered high risk, from an auditor's perspective.

The distribution of all internal control incidents was relatively equal across the three categories.



Since the pandemic we have observed further increases in identified internal control weaknesses.

Overall Management Response

In most cases, management of the Arenas made strong efforts to address the communicated weakness, evidenced by a removal of management letter point from our correspondence in the following year. However, finding internal control weaknesses across three categories equally indicates a weak control *environment*.

As auditors, we are required to communicate significant deficiencies in internal controls to the Arena boards. Many incidents are rightfully considered minor in nature, which we would communicate with management. Often, we highlight these weaknesses to management first so that they may address the issue before we bring it to the Board's attention. These types of issues, if addressed in a timely manner or remain insignificant, were not included in the above data.

Ultimately, management is accountable to each Arena's governing board for its overall response to identified internal control weaknesses.

Areas for Improvement

When we dig into the nature of the internal control weaknesses identified, they point to three key areas where the Arenas can make improvements: capacity and knowledge, processes, and technology. In general, these three areas are often intertwined.

Capacity and Knowledge

Several arenas have experienced (and continue to experience) a lack of accounting and financial management capacity. This issue persists in a variety of ways.

Since the pandemic, the accounting industry is experiencing a shortage of qualified staff which means finding the right people has also become more expensive. Additionally, Arenas may have the right staffing and expertise to manage the affairs of the arenas but lack the specific financial management and accounting expertise to improve the control environment and reporting processes.

Processes

There are a number of processes in every entity that are essential to sound internal control and governance. Reconciliation of cash, receivables and payables, payroll and tax deductions, documentation of board minutes, year-end adjustments, etc.

Many Arenas had dated processes before the pandemic. This remains an issue today.

Technology

Accounting software and technology has become pervasive across the accounting industry and has become critical in business decision-making processes.

Arenas appear to use their own individual solutions to address accounting software and reporting, which leaves deficiencies when it comes to tracking financial information. Perhaps more importantly, limited financial information means limited insights. The revenue or cost analysis that can be performed by management is also limited. A prudent governing board may not be able to get relevant and complete information to make key decisions regarding the Arena's future.

Integration with the City’s Consolidation Process

As discussed above, City of Toronto’s Controllership Office does not consolidate the current year’s financial statements for the Arenas. As financial results have historically been delayed, the controllership uses the prior year results to complete the current year consolidation. The controllership is able to do this as the difference between current and prior year Arena financial results is presumed to be immaterial.

In evaluating next steps, it is important to consider the Controllership’s overall consolidation requirements and any financial reporting compliance that may arise for the Arenas

Recommendation: Evaluate new governance structures

In the sections above, we analyzed the underlying causes for untimely financial reports among the Arenas. We also highlighted some key trends regarding internal control weaknesses that pose a risk to governance.

We recommend that the City of Toronto evaluate new governance structures that may improve the underlying control and governance issues.

Centralized Accounting for All Arenas

One way to alleviate the accounting and reporting burden placed on the Arenas is centralize the accounting, reporting and documentation processes. Central resources can be used to house financial knowledge and capacity, increase use of technology, and modernize internal control processes and documentation. Central resources can maintain and update all the accounting, finance and board documents on behalf of each Arena.

This is a strategy often deployed by other industries, such as when a parent company has many small subsidiaries to monitor. A transition to this model would require all Arena entities to utilize the same services or systems for accounting, cash management, and payroll.

This has several benefits:

- Segregates the accounting / record-keeping duties from Arena management (automatically enhancing controls over potential fraud).
- Encourages digitization of accounting and supporting documentation, including payment processes.
- Implements a common accounting and reporting system across the Arenas, which would assist in modernizing all financial policies and processes across these entities. This would improve timeliness of financial reports and facilitate faster consolidation.
- It would provide governing boards immediate access to financial comparisons across all Arenas, enhancing governance and oversight.
- It may save costs associated with accounting, as centralized resources are shared across the portfolio of the Arenas.

Centralization of the Arenas may come in different forms. Another option may be to bring the Arenas into the Department of Parks, Forestry and Recreation, for example. This would also lead to centralizing the accounting and finance functions of all the Arenas to improve processes, technology, and capacity – with the express aim of better accountability over Arena operations and reporting. However, this option comes with additional risks and benefits which are not within the scope of this report.

Our suggestion is for the City to evaluate new governance structures that may address the issues highlighted in this report and improve the overall governance model of the Arenas.

Recommendation: Evaluate different levels of assurance

As the City considers new governance models for the Arenas, it should also consider what level of assurance is appropriate under any new governance model selected.

Status Quo

Currently, the Arenas are required to prepare general-purpose financial statements that are audited by an independent audit firm. This is the highest level of assurance that can be provided on the financial statements. However, for smaller entities, this can impose an administrative burden as the preparation of general-purpose financial statements requires strict conformance to public sector accounting standards (which can be complex) and includes detailed note disclosures to accompany the core set of financial statements, which may not prove useful to the governing board.

Financial Statement Reviews (Not an Audit)

While a financial statement audit provides a reasonable level of assurance that financial statements are fairly stated, a lower level of assurance, like a financial statement review, may pose a less administrative burden on the Arenas.

When a public accounting firm reviews the financial statements instead of auditing them, the auditor is not independently verifying third parties cash balances, physically counting inventories, etc. To conduct a financial statement review, an auditor relies on the financial information prepared and performs a number of analytical procedures to obtain comfort over the numbers.

Special Purpose Procedures (Auditing only certain transactions or balances)

Another alternative is to design special purpose audit procedures to perform on transactions that occurred during the year or balances that exist at year end. For example, if we want to ensure the Arenas have spent its funds appropriately during the year, special purpose procedures can focus on testing and verifying expenses to ensure they did in fact occur, have been recorded accurately, and have been itemized and classified correctly.

Special purpose procedures can be tailored to the Arenas as a group or to each individual Arena. They may also prove to be less administratively burdensome than the status quo as the work of the auditor focuses on the areas of highest risk and importance to governing boards. These procedures can also be tailored to complement a new governance structure. This type of assurance engagement lends itself to simpler financial reporting that focus on budget and actual financial results that are meaningful to governing boards, as opposed to complicated note disclosures that may not be as relevant.

Our recommendation is for the City to evaluate the different levels of assurance that would complement any new governance structure, keeping in mind the consolidation requirements of the City of Toronto’s Controllership Office.