AUDIT GUIDELINES FOR AGENCIES

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PURPOSE AND OVERVIEW

This document has been prepared to provide guidance to Agencies that receive funding from the City of Toronto (the City) and are required to submit audited financial statements or a review engagement report. The purpose of the document is to assist bookkeepers and auditors that are appointed by Agencies and to assist the user in understanding Toronto Children's Services (TCS) requirements regarding the use of public funding as well as the requirements that must be met in submitting audited financial statements or review engagement report. This guideline provides an additional resource to use concurrently with the budget guidelines and funding application guidelines. It also provides information to Agencies on how the financial statements are used by TCS.

This guideline is intended as a resource only and the agency has sole responsibility for adequate use of this document. If you need clarification, you may contact your TCS Budget Consultant or Budget Coordinator. You may visit the CPA website for accounting and auditing standards, searching for a CPA, or reporting concerns regarding a CPA.

WHAT IS AN AUDIT?

An audit is an independent review and examination of financial records and activities to assess the efficiency of controls, to ensure compliance with established policies and procedures, and to recommend necessary changes in controls, policies, or procedures to meet objectives. The auditor is an independent 3rd party and is responsible to express an opinion on the audited financial statements based on their audit.

It is the responsibility of the agency receiving funding from TCS to comply with our guidelines and terms and conditions of the funding agreement. TCS guidelines and funding agreement information should be communicated to the auditor by the agency.

WHAT IS A REVIEW ENGAGEMENT?

A review engagement is an independent review of financial records to ensure the financial statements are free from material misstatement. The review engagement provides a meaningful level of assurance, whereas an audit provides a high level of assurance. The public accountant is responsible for expressing a conclusion on whether the financial statements are prepared in accordance with the applicable framework.

It is the responsibility of the agency receiving funding from TCS to comply with our guidelines and terms and conditions of the funding agreement. TCS guidelines and funding agreement information should be communicated to the auditor by the agency.
**WHO MUST SUBMIT AN AUDITED FINANCIAL STATEMENT OR REVIEW ENGAGEMENT TO TCS?**
In accordance with City policies and applicable Provincial guidelines, all centres must provide TCS with the required financial statements **within four months** of the organization's fiscal year end if they receive the following within a calendar year:

<table>
<thead>
<tr>
<th>Funding Type</th>
<th>Annual Threshold</th>
<th>Financial Report</th>
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</thead>
<tbody>
<tr>
<td>Fee Subsidy</td>
<td>$30,000</td>
<td>Audited financial statement</td>
</tr>
<tr>
<td>Any combination of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• General Operating Funding (GOF)</td>
<td></td>
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<tr>
<td>• 2018 One-Time Stability Grant</td>
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<td></td>
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<tr>
<td>• Minor Capital/Health and Safety</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Wage Subsidy/ Wage Improvement (Home Child Care Only)</td>
<td>$20,000</td>
<td>Audited financial statement</td>
</tr>
<tr>
<td>• 1999-2005 Pay Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Any combination of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Provincial Wage Enhancement Grant (PWE) and Home Child Care Enhancement Grant (HCCEG)</td>
<td>$20,000</td>
<td>Review engagement</td>
</tr>
<tr>
<td>• Fee Stabilization Support</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Summer Day Program Funding</td>
<td>$20,000</td>
<td>Audited financial statement (Unaudited is required if less than $20,000)</td>
</tr>
<tr>
<td>Special Needs Resource Funding</td>
<td>$20,000</td>
<td>Audited financial statement</td>
</tr>
<tr>
<td>EarlyON Child &amp; Family Centres and Journey Together Programs</td>
<td>All Programs must submit audited financial statements, regardless of funding level</td>
<td>Audited financial statement</td>
</tr>
</tbody>
</table>

When a location is part of a larger agency with more than one location or service, the funding thresholds outlined above are set at the agency level.

A review engagement is minimally required for the applicable agencies. An audited financial statement may be submitted as an alternative as it provides a higher level of assurance.

Agencies who are unable to meet the audit submission deadline must submit an extension request in writing to their Children's Services Budget Consultant. The extension request should include the
reason for the extension as well as the anticipated submission deadline. Failure to submit the required statements in the specified format may result in sanctions being applied. This may include suspending the fee subsidy advance payment or holds on quarterly payments.

**AUDIT REQUIREMENT UPON TERMINATION OF SERVICE AGREEMENT**

In the event that a Service Agreement between the Agency and the City of Toronto is terminated, audited financial statements are required from the first day of the agencies current fiscal year to the last day of operation. The final payment for the last month of operation will be held until the audited financial statements for the period are received and analysed as well as any other outstanding reporting requirements, and it is determined that no overpayment has been made. As outlined in Subarticle 3.6 of the Service Agreement:

> Upon termination of this Agreement, the Agency shall reimburse forth-with to Toronto any monies advanced by Toronto which are not expended in accordance with this Agreement.

**REQUIRED FORMAT**

- Revenue and expenses reported in the audited financial statements should be presented using the same categories listed in the budget submission; otherwise agencies will be required to provide a separate report to reconcile the audit and the current budget.
- The audited financial statements for organizations that have more than one location or program must include a breakdown of revenue and expenses by location and/or program for the current and previous fiscal years. The statements must also show the surplus/deficit for the beginning and end of the year and must provide net assets/retained earnings by location.
- All funding types received from TCS must be reported separately from any other revenue sources (e.g. fee subsidy revenue, parent fees, general operating funding, grants etc.).
- Organizations who received Provincial Wage Enhancement (PWE), Home Child Care Enhancement Grant (HCCEG), Fee Stabilization Support (FSS) and/or 1999 – 2005 Pay Equity are required to submit a Special Purpose Report, verifying the funding has been used for the purpose(s) intended. The Special Purpose Report must be included as part of the agency's financial statements, or provided in a separate auditor's report reconciling grant and/or pay equity payments against actual expenditures.
- In accordance with the requirement stated above, the agency's financial statements must provide a breakdown of staffing costs by reporting salary expenses and benefit expenses separately.
- The audited financial statements must be audited in accordance with Canadian Auditing Standards and the financial statements must be prepared using the appropriate accounting standards.
• The audit and review engagement must include 4 main statements (Statement of Financial Position/Balance Sheet, Statement of Operations/Income Statement, Statement of Change in Equity/Statement of Change in Net Assets and Cash Flow Statement) and note disclosures.
• The auditor is responsible to form an opinion (or a conclusion for a review engagement) on the financial statements and issue an auditor report (or review engagement report).
• Organizations may be required by TCS to revise and resubmit financial statements that do not comply with the Canadian Auditing Standards and/or the required format as outlined in these guidelines.
• When an organization receives a management letter from an auditor, the organization is required to submit a copy of the management letter and a copy of management’s written response to TCS.

**QUALIFIED AUDIT OPINION**

In cases where the auditor is unable to gather sufficient evidence for various aspects of the financial statements, a qualified opinion may be given due to the limitation of scope. Without sufficient verification of transactions, an auditor may be unable to issue an unqualified opinion.

TCS will review the qualification to determine whether the issues raised by the auditor comply with our guidelines. Any qualification may require further review by TCS and may result in sanctions applied from TCS to the Agency. TCS may request more information from the agency during this subsequent review.

**SANCTIONS AND PENALTIES**

In order for the City to effectively maintain our financial reporting obligations, TCS will be implementing sanctions and penalties for non-compliance with business deadlines. Under exceptional circumstances, an extension request may be made to your Budget Consultant. Agencies who fail to submit required financial statements, reports and other supporting documents on a timely basis may be subject to the following sanctions and penalties:

• Forfeit their funding increases or grant eligibility if no submission is received by budget/grant deadlines
• Payment Schedule adjusted from Quarterly Advances to Monthly Advances
• Payments suspended until issue is resolved
• Further sanctions including, but not limited to: termination of the Service Agreement between the City of Toronto and the Agency, the recovery of funds, and no consideration for expansion of locations or service levels
AGENCY RESPONSIBILITY

An agency’s Board of Directors and/or management has the responsibility for overseeing the organization and its financial matters. This important duty of financial oversight encompasses a large scope of responsibilities including fulfilling reporting responsibilities, establishing compensation, approving the annual budget and expenditures, and monitoring revenue. The overall goal of the Board of Directors and/or management includes, but are not limited to:

- Establishing and ensuring the organization’s compliance with proper financial systems and controls;
- Regularly evaluating the organization’s financial health and viability;
- Ensuring compliance with the Service Agreement;
- Ensuring the Agency's compliance with the financial reporting obligations as per TCS budget and funding guidelines; and
- Ensuring that there is a signed contract in place prior to the commencement of any audit or review procedures that outlines the terms of the audit or review engagement, and that the auditor is a Chartered Professional Accountant in good standing.

For non-profit agencies, it is important that the Board composition should include some members that possess finance experience and that all Board Members possess enough financial literacy to understand basic terminology, read and evaluate financial statements, and be able to ask the right questions in determining the financial viability and compliance with the Service Agreement.

It is important to acknowledge that the agency, bookkeepers and auditors have different roles and responsibilities within an organization so that there is a segregation of duties:

- Agency is responsible for the overall financial health, ongoing viability of the program/centre and all requirements of the Service Agreement
- Bookkeepers (appointed by the agency) are responsible for recording transactions
- Auditors (appointed by the agency) are independent 3rd party’s responsible for issuing an opinion on the financial statements

It is important to appoint Bookkeepers and Auditors that have knowledge with Early Learning and Care including EarlyON Services, sector funding mechanisms as well as TCS Service Agreement and reporting requirements.
APPROVAL OF THE FINANCIAL STATEMENTS

The audited financial statements or review engagement report must be signed by the Operator (for commercial organizations) or by two Signing Officers (for non-profit organizations). For non-profit organizations, the signing officers are members of the Board of Directors, which are listed on the Form 1 – Ontario Corporation Initial Return/Notice of Change. The Supervisor or Executive Director is not a member of the Board of Directors and as such, their signatures are not acceptable.

Non-profit agencies need to submit a copy of the Annual General Meeting Minutes each year. The minutes shall include the approval of previous year’s AGM minutes, approval or availability of previous years audited financial statements, election of the Board of Directors and appointment of the auditor.

TORONTO CHILDREN’S SERVICES (TCS) FINANCIAL STATEMENT ANALYSIS

TCS uses the financial statements as a mechanism to ensure accountability for the use of public funds, which the City provides to agencies. The agency shall use the funds provided only for the expenses that directly support the provision of child care and early year services and as outlined in the approved budget and program budget guidelines. Note that there are a number of different budget guidelines and they are individual by program type i.e child care, EarlyON, Special Needs etc. City funding must be used to provide services within the City of Toronto and are not permitted to support programs outside of the City of Toronto. Audited financial statements or review engagement reports provide TCS with independent verification (3rd party verification) on the use of public funds.

TCS also uses the audits to compare actual to budgeted revenue and expenses in order to support the following year's budget submission. Variances between budget and actuals (as per audited financial statements) provide TCS with useful information regarding changes that may have occurred during the year and identify areas where additional support/capacity building may be needed.

Analysis of audited financial statements or review engagement report entails a review by TCS of amounts reported in revenue and expense categories by the agency compared to the approved budget or funding guidelines to ensure public funding has been used for the purpose for which it was provided. Audit analysis also includes a review of the financial health of an organization and is used to determine any surplus/deficit and any potential recovery. Comparing budgeted amounts to the amounts in the audit will identify any significant variances requiring follow-up.

T4 VISIT AND SALARY & BENEFIT ANALYSIS

Salaries and benefit costs represent approximately 80% of expenses in child care and early year services, therefore specific detail is required related to this category and particular emphasis will be
given to this area during TCS analysis. A review of T4s and analysis of salaries and benefits in the audited financial statements will highlight any of the following issues:

- Compliance with legislative requirements such as minimum wage
- Significant variances from T4s to budgeted salaries
- Any payments to staff (including but not limited to dividends and bonuses) as part of total compensation, which will be compared to budgeted salaries and maximum allowable salaries in the guidelines. Payments in excess of what has been approved in the budget or in excess of TCS salary maximum may result in a recovery
- Using General Operating Funding in accordance with guidelines and approved implementation plans
- Identify over/under-staffing or efficiencies or inefficiencies
- Composition between casual and permanent staff
- Reasonableness of central allocated administration in the budget compared to actual T4 for staff

In the event that any issues or concerns about the use of public funding are noted during this analysis, TCS may request additional information from the agency and may apply sanctions if there is concern or evidence that funding has not been applied as approved.

**Prescribed Use of City Funding**

The City of Toronto, through Toronto Children’s Services, is accountable, through legislation, for the funding and the policy decisions that determine funding for agencies. Given their key role in providing and supporting child care and early year services, agencies have important accountabilities to the community and the City. A basis of the child care system is the principle that agencies have a responsibility to ensure the effective use of City Funding and of other funding agencies, where applicable. Thoughtful, transparent budgeting, aligned with a focused strategy, is vital and integral to this goal.

Agencies who have a contract with TCS are not permitted to distribute public funding to any individuals or corporations, that do not directly support the provision of child care and early year services as approved in the annual budget submission. Allowable operating surpluses are expected to be retained for future use for child care and early year services and are not to be transferred to other corporations or entities.

Although certain transactions may be presented in accordance with appropriate accounting standards in the agency’s financial statements, and comply with Provincial or Federal legislation governing
commercial or not-for-profit corporations, funding must be used in accordance with the terms of the Service Agreement Subarticle 4.2 as stated:

_The Agency shall use the funds provided by Toronto pursuant to Subarticle 4.1 only for the specific purpose for which the funds are provided, and in accordance with the budget submitted by the Agency._

**Transactions not funded by the City include, but are not limited to:**

- loans to employees, shareholders, board members, directors, related parties/corporations, etc.
- advances to shareholders, directors, related parties/corporations, etc.
- funds used to pay for expenses that do not directly relate to the child care centre or program for which the funding has been provided (e.g. expenses incurred by shareholders, other child care centres/programs, related parties/companies, etc.), this may include inter-company transfers, allocations or chargebacks, or drawings on equity
- Dividends
- Funds used for child care and early year services provided outside of the City of Toronto
- Funds used for child care and early year services in the City of Toronto for programs/locations that do not have a contract, or are a service agreement with the City of Toronto
- Bad debt expenses
- Goodwill written off
- Loan interest
- Principle portion of a loan
- Personal vehicle expenses or maintenance for vehicles, insurance, gas
- Head office rent
- School bus expenses (including insurance)
- Associated business enterprises including a charity of the agency
- Other costs not included or approved as per budget/funding application guidelines or that do not directly support the provision of services to children and families in the City of Toronto
- Any expenses over and above the threshold set in the budget/funding application guidelines

Any of these expenses will be disallowed during audit analysis and could potentially lead to a recovery of funding by TCS.
DIVIDENDS

TCS recognizes that a commercial agency may issue dividends in accordance with the Corporations Act. In the event that dividends are issued, TCS requires that the agency submit the T5 to the Budget Consultant and/or Budget Coordinator. The dividends paid will be included as the total compensation during TCS analysis, which cannot exceed the TCS budget/funding application guidelines. Any excess over the approved budget submission and/or the budget/funding application guideline maximum will be disallowed and may result in a potential recovery.

AUDITED FINANCIAL STATEMENTS-SURPLUS / DEFICIT

Agencies are encouraged to accumulate a surplus up to three months of average operating expenses in order to meet unforeseen contingencies. Agencies are required to submit a plan to the Budget Consultant for the use of any accumulated surplus (that exceeds three months of average operating expenses) identified in the audit for City funded programs. The expectation of the agency is that the surplus is reinvested into the program it was intended for through the submission of the annual operating budget and used to support the provision of child care and early year services. Surplus in a given year that exceeds 10% of allowable revenue may result in a recovery.

For Special Needs programs, if an operating surplus exists related to TCS funding, and is specifically driven by underspent Salaries & Benefits in comparison to the submitted budget, the agency must submit a plan on the use of the underspent funding to the Resource Supervisor. The agency will be notified if the plan is acceptable and if not, a recovery will be processed for the full amount of underspent funding.

For EarlyON and Journey Together programs, a plan will be required on the use of any accumulated surplus (that exceeds the recommended amount) identified in the audit for any City funded program. Excess surplus in a given year may result in a recovery if an overpayment has occurred.

When an agency has incurred a deficit, TCS will review the audited financial statements during the audit analysis and if necessary request a business plan. TCS will analyze the impact on financial viability and consider the materiality of the deficit as well as changes over the prior year. The business plan should be realistic and identify how the deficit will be addressed in the following fiscal year.
OVERPAYMENT AND RECOVERY

The agency must inform their Budget Consultant immediately of any overpayments made by the City, which should be returned to the City within a pre-arranged period. Any overpayment determined through a grant reconciliation must be returned with a signed reconciliation statement. The grant reconciliation will also be reviewed with the audited financial statements and/or review engagement.

TCS may also determine that a recovery is required through the following:

- T4 analysis
- Audited financial statement analysis (for up to 7 fiscal years prior)
  - Excess of 10% operating surplus in the fiscal year
  - Accumulated surplus exceeding a reasonable amount that is not being reinvested into child care and early year services
  - Transactions not funded by the City, including Dividends
  - Underspent funding related to Special Needs programs, EarlyON & Journey Together programs
- Inconsistent operating capacity resulting in General Operating Funding change or General Operating Funding not used in accordance with the guidelines and/or implementation plans, if applicable
- Per diem recovery (when TCS determines an agency's per diem is higher than their public fee)

Any expenses not funded by the city as mentioned in this guideline will increase the surplus and lead to a potential recovery, which will be adjusted, to reflect the percentage of city funding to total revenue. A repayment plan is negotiable on an individual basis, which considers timely repayment as well as the agency's ability to pay. TCS may withhold final monthly payments to recover the amount as determined through the recovery calculation.
Example of a Recovery Calculation for an Agency with Fee Subsidy:

Recovery Calculation for Year Ended December 31, 20xx

Information from Audit Analysis
Allowable Revenue A $120,000
Allowable Expenses (disallowed expenses are removed from this amount) B $90,000
Operating Surplus (A-B) C $30,000
Operating Surplus % (C/A) D 25%

Revenue Information from Statement of Account/ Payment Summary
Parent Portion of Fees E $30,000
Subsidy Fees F $70,000
General Operating Funding G $9,000
Total Fee Subsidy & General Operating Funding (E+F+G) H $109,000

Recovery Calculation
City Funding % of Allowable Revenue (H/A) I 90.83%
10% of Allowable Revenue (A*10%) J $12,000
Excess Operating Surplus over Allowable Revenue (C-J) K $18,000
Recovery Amount (K*I) L $16,350

RESOURCES

There are a number of resources available to support Agencies with the responsibilities to manage a child care and early years operation. Toronto Children's Services staff are available to support any interpretation needed for budget and operating guidelines and also for any audit or recovery process questions. Please contact your Budget Consultant for any support needed.

The following websites may also be used to access additional information:

Children's Services for Operators – www.toronto.ca/children/operators
  • Budget and General Operating Funding Guidelines
Chartered Professional Accountants of Canada- https://www.cpacanada.ca/
Chartered Professional Accountants of Ontario - https://www.cpaontario.ca/