# Request for Decision

## 2010 Audit of Contract Management - Transit Kiosk and Cafe Agreements

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|---|---|
| Presented To: | Audit Committee |
| Presented: | Wednesday, Oct 05, 2011 |
| Report Date | Thursday, Sep 29, 2011 |
| Type: | Presentations |

**Recommendation**

The Auditor General recommends that:

1. Recommendations in the attached Auditor General's report entitled "2010 Audit of Greater Sudbury Transit Services - Transit Kiosk and Café Contract Management" be adopted.

2. That the status of management responses and action plans be reviewed by the Audit Committee in April of 2012.

(See attached report)

Signed By

**Auditor General**
Brian Bigger
Auditor General
*Digitally Signed Sep 29, 11*

## Summary

Attached is the Auditor General's report entitled "2010 Audit of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management". The Auditor General's 2010 Audit Work Plan included a program audit of the City's Transit Services Division. As part of the audit, we examined various contracts that were under the administration of Transit management. The observations, conclusions and recommendations in this audit directly relate to the administration's accountability for the quality of stewardship over public funds.

The objective of the audit was to evaluate the quality of stewardship over public funds relating to the issuance, renewal and administration of contracts. Due to the loss incurred by the City in the operation of the Transit Kiosk, the Auditor General also evaluated the risks and controls related to the management of all three contracts with 1211250 Ontario Inc.

While we recognize the initiatives introduced by the Finance Department and the Transit Services Division to improve controls over receivables and contract management, more work is required in order to address the recommendations in this report.

The Auditor General is providing this report to Council, in it's entirety.

The attached report contains twenty one recommendations along with a management response to each of the recommendations.

## Comments

The role of the Auditor General is to encourage people to adopt good practices that are supportive of, or enhance the quality of stewardship over public funds, and the achievement of value for money through operations.

The main operational function of the Auditor General's Office is to complete audits, recommend improvements often with the advice of management, and to provide those reports to Council. The Auditor General assists Council Members by providing information that is intended to support their oversight role in accordance with the Municipal Act (2001)

(a) to represent the public and to consider the well-being and interests of the municipality;

(b) to develop and evaluate the policies and programs of the municipality;

(c) to determine which services the municipality provides;

(d) to ensure that administrative policies, practices and procedures and controllership policies, practices and procedures are in place to implement the decisions of council;

(d.1) to ensure the accountability and transparency of the operations of the municipality, including the activities of the senior management of the municipality;

(e) to maintain the financial integrity of the municipality;

(f) to carry out the duties of council under this or any other Act. 2001, c. 25, s. 224; 2006, c. 32, Sched. A, s. 99.

In order to be effective, the Auditor General's Office is heavily reliant on the continued cooperation of council and management.

Audits, out of necessity, are limited in scope, and often reflect conditions that existed at a certain point in time or over a specific period of time. The Auditors have the unique opportunity to compile vast amounts of information related to a specific topic and evaluate that information through hindsight. Also out of necessity, the auditor's focus is on what in the auditor's opinion, can and should be improved. Observations, findings, and conclusions found in our report

should NOT be interpreted to be a comprehensive appraisal of personal performance. They should not be used to place blame, for events that have occurred in the past, but instead to identify areas that can be improved in the future.

That said, it should be clear to the report reader, why the Auditors expanded the extent of their Transit audit review, when much of the following information became apparent.

As the contract with the City provided no legal basis for either the Company or any of its Directors to keep the proceeds of the sale of the City's transit tickets for themselves, the Auditor General has been unable to determine any equitable or legal basis for the Company Director(s) to claim that the City's money was theirs to spend. The Auditors have asked City management to explain why, if the Company Director(s) received the financial benefit of the contract personally, they should not also bear the contractual burden of repaying the Taxpayer's money. To date, no clear and compelling explanation has been received as to why the lawsuit against the Company was not expanded to include the Company Director who received the payments personally, or alternatively, why that individual was not sued in a separate lawsuit.

Ontario's Limitations Act imposes a statutory time limit within which to sue. It is 2 years after the cause of the lawsuit arises. After that date has passed, unless the City could prove that it was unaware that it had the right to sue, the City would likely have no further ability to sue the individual to recover its money. The cost to preserve the City's ability to recover the money through a civil claim was estimated to be approximately $5,000.

In the Auditor General's opinion, delays in the receipt of management responses and the release of this report to Council may have greatly reduced the timely relevance and usefulness of this report.

*Auditor General's Office*

Audit Committee Report

# *2010*

# *Audit of Greater Sudbury Transit Services*

*Transit Kiosk and Café Contract Management*

*Brian Bigger, C.G.A*

*Auditor General, City of Greater Sudbury*

Auditor General's Report
Action Required

# 2010 Audit of Greater Sudbury Transit Services Transit Kiosk and Café Contract Management

## Audit Overview

| | |
|---|---|
| Fieldwork Complete Date: | June 13, 2011 |
| Draft Report Date: | July 12, 2011 |
| Final Report Date: | October 5, 2011 |
| To: | Audit Committee |
| From: | Brian Bigger, Auditor General |
| Audit Number: | 2010GRTH07C |

## Summary


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The attached report contains twenty one recommendations along with a management response to each of the recommendations.

## Recommendations

The Auditor General recommends that:

1. Recommendations in the attached Auditor General's report entitled "2010 Audit of Greater Sudbury Transit Services - Transit Kiosk and Café Contract Management" be adopted.

2. That the status of management responses and action plans be reviewed by the Audit Committee in April of 2012.

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In the Auditor General's opinion, delays in the receipt of management responses and the release of this report to Council may have greatly reduced the timely relevance and usefulness of this report.

## Contact

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## Signature

Brian Bigger, Auditor General

## Attachments

Appendix 1: "2010 Audit of Greater Sudbury Transit Services - Transit Kiosk and Café Contract Management" Audit Report

Appendix 2: "2010 Audit of Greater Sudbury Transit Services - Transit Kiosk and Café Contract Management" Management Response

*Auditor General's Office*

Final Audit Report

# *2010*

# *Audit of Greater Sudbury Transit Services*

## *Transit Kiosk and Café Contract Management*

*Brian Bigger, C.G.A*

*Auditor General, City of Greater Sudbury*

Report# 2010GRTH07C Fieldwork Completed: June 13, 2011

This audit was performed by the Auditor General pursuant to section 223.19 (1.1) of the Municipal Act, 2001, S.O. 2001, c.25 in accordance with generally accepted government auditing standards (International Standards for the Professional Practice of Internal Auditing, as set by The U.S. Government Accountability Office).

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# EXECUTIVE SUMMARY

Why we conducted this review

The Auditor General's 2010 Audit Work Plan included a program audit of the City of Greater Sudbury's (the City) Transit Services Division. As part of the Transit Services audit, we examined various contracts that were under the administration of Transit management. Due to the significance of issues surrounding the management of the Transit Kiosk, Transit Café and Airport Café contracts, the Auditor General's office has decided to provide results of their review under separate cover. The observations, conclusions and recommendations in this audit directly relate to the administration's accountability for the quality of stewardship over public funds. While this report covers only one contracted relationship, if the issues found in this case are not unique, significant reform of the City's contracting processes are necessary.

We followed 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives of the review

The objective of the audit was to evaluate the quality of stewardship over public funds relating to the issuance, renewal and administration of contracts. Due to the loss incurred by the City in the operation of the Transit Kiosk, the Auditor General evaluated the risks and controls relating to the management of all three contracts with 1211250 Ontario Inc.

Audit methodology

Our audit included the following:

- Reviewed the contracts for the operation of the Transit Kiosk,

the Transit Café and the Airport Café;

- Reviewed relevant policies, procedures and bylaws;
- Reviewed transactions and supporting documents such as cancelled cheques, invoices, etc. from 2004 to the termination of the contracts, relating to the payment of the monthly management fee, sale of Transit tickets on consignment and other revenues owed to the City under the terms of all three contracts;
- Requested and reviewed copies of letters to management and information provided to Council from the external auditors;
- Reviewed various legal documents relating to the closure, collection attempts and court judgment for the outstanding account receivable;
- Conducted interviews with Transit management, Finance management and the City Solicitor;
- Consulted with outside legal counsel;
- Reviewed and discussed findings with management.

Summary of key issues and recommendations

Our review identified the following:

- Management did not administer the contract according to its terms.
- Certain City policies, procedures and bylaws were not followed in the management of the account receivable for 1211250 Ontario Inc.
- Controls of the use of alternate payee fields in payment processing need to be enhanced.
- Additional due diligence is needed as part of the contract award process.

The following report contains 21 recommendations. The implementation of these recommendations will contribute to improvements in the management of City contracts.

## BACKGROUND

1211250 Ontario Inc. was operating the Transit Kiosk, Transit Café and Airport Café

The Transit Kiosk, Transit Café and Airport Café were previously operated by 1211250 Ontario Inc. (the Company). There were two Directors of this numbered company, one of which was an active participant in the daily operations of the business. The Transit Café and Transit Kiosk were operating under separate contracts with the City. The Airport Café's contract was with the Sudbury Airport Community Development Corporation.

When the contract was terminated, the Company owed the City $866,706

A Notice of Default was issued by the City days before the Airport Café, the Transit Café and Transit Kiosk were closed by City management on or about September 4, 2009. At this time, 1211250 Ontario Inc. owed the City $866,706.

Claims against the Directors personally have not been made

In the spring of 2010 the City launched a lawsuit against 1211250 Ontario Inc. in order to recover monies owed to the City for the proceeds of ticket sales not remitted to the City. At this time, the City has not pursued claims against the Director(s) personally.

The City received a judgment for payment of $578,816

March 31, 2010 the City of Greater Sudbury won a judgment against 1211250 Ontario Inc. to pay the City $578,816 plus costs of $1,211, as the City had only been able to recover $287,910.

The City recovered $287,910 of these funds

The City had recovered the initial $287,910 through letters of credit held on the existing contracts, one certified cheque, cash on hand at the three operations as well as $96,000 of unsold transit tickets held in inventory at the Transit kiosk. After applying these amounts to the balance owing, the City is still owed $578,796 as no further recoveries have occurred since March 31, 2010, when the City of Greater Sudbury won their judgment.

No further monies have been collected to date

In 2009 a $500,000 bad debt

In 2009, the City had established an allowance against these

expense was recorded against Transit Services revenue

monies owing. As a result, a $500,000 bad debt expense was recorded against Transit Services revenue.

A number of events and/or decisions had occurred throughout the terms of the contracts which will be highlighted in this report. Key events and/or decisions as well as outcomes of these events/decisions are highlighted in Summary 1 (attached at the end of the report).

Many of the recommendations made within this report should also be applied to other contracts within the City. Proper contract management is essential to achieving value for money as well as safeguarding public assets.

## TRANSIT KIOSK CONTRACT

History of Transit Kiosk ticket booth

The Transit Centre Kiosk began operating shortly after the terminal opened in 1997. Operations consisted of the sale of bus tickets and passes on behalf of the City, as well as the sale of lottery and Nevada tickets. Around early 1999, the former operator of the ticket kiosk was closed down due to the operator defaulting in their agreement with the former City of Sudbury. At this time, part-time City of Sudbury staff were brought in to sell Transit bus passes at the kiosk.

Due to time constraints in getting another contractor in to sell lottery and break-open tickets as well as Transit passes, the City of Sudbury entered into an agreement with the owner and operator of Zio's In-Transit Café which was already operating within the Transit Centre.

April 1, 1999 - First contract with 1211250 Ontario Inc for the operation of the Transit Kiosk

At that time, management reported to Council that they were satisfied that the agreement negotiated with the Company "provides the necessary safeguards and security to protect the corporation from financial loss should the operator default in its payments." The contract took effect April 1, 1999 to August 31, 2002. The contract was held over on a month to month basis while the City conducted a procurement process and in June 2004, a new contract was signed

with the successful and only bidder.

Contract was renewed in June 2004

In June 2004, the contract was awarded to the same vendor (1211250 Ontario Inc., operating as Zio's Tuck Shop). The City tendered and awarded the right to operate a ticket counter and information booth kiosk at the Sudbury Transit Centre between June 1 2004 and January 31, 2007, with renewals of the contract contingent on satisfactory performance for three years.

Contract expired January 31, 2009, but was held over from February 1, 2009 until the date the kiosk was closed (September 4, 2009)

This contract expired on January 31, 2009. According to the contract, "the City and the Operator may negotiate further rights or options to renew beyond the expiry of the final extension, provided that the Operator gives three (3) months' written notice to the City of its intention to exercise the right of renewal." Therefore, the contract was held over from Feb 1, 2009 to the date the kiosk was closed (September 4, 2009).

The City issued an RFP for the operation of the Transit kiosk on August 11, 2009. The only company that submitted a proposal was 1211250 Ontario Inc. Transit management decided that they would not award the contract and instead, would operate the kiosk in house using Transit staff.

## COMPARISON OF CONTRACTS

Audit compared key terms of the contract for the Transit Kiosk that was entered into in 1999 with the former City of Sudbury, to the contract terms that were in effect at the termination of the contract in 2009. Some contract terms remained the same; others were modified when the contract was renewed in 2004. These key terms are highlighted as they will be referred to later in the report.

| Contract Terms for the Transit Kiosk That Changed Between 1999 and 2004 Contracts | | |
|---|---|---|
| | 1999 Contract Terms | 2004 Contract Terms |

| | | |
|---|---|---|
| Security deposit for lottery booth | A security deposit was required for the operation of the lottery booth. | No separate security deposit was required for the operation of the lottery booth. |
| Commission rate for sale of bus tickets | The City was paying the Company 1.75% of the total sale of bus tickets or $36,000 per year, whichever is greater for selling Transit tickets. | At termination of the contract, the City was paying the Company $136,000 per year , (a flat fee of $11,375 per month) when the contract was terminated. |
| Right to offset against monies owed to the City | The City had the right to offset all or part of the rental payments owing to the Company against monies owed to the City. | Although it is part of the City's Account Receivable policies and procedures, the right to offset was not specified in the contract. |
| Letter of Credit | The Letter of Credit the City held was for $50,000. | The Letter of Credit the City held was for $75,000. |
| Audited financial statements | Within 3 months of the end of each fiscal year or termination of the lease, the Company was to submit audited financial statements. The audited financial statements shall contain a statement from a licensed public accountant stating his or her opinion without qualification. | The Company was to submit audited financial statements upon request by the City. |
| ATM machine | No provision for an ATM machine. | There was a clause for the operation of the ATM machine by 1211250 Ontario Inc. |
| NSF Fees | NSF fee of $500 could be charged on NSF cheques. | NSF cheques were not addressed. |
| Rent on space for sale of lottery tickets | The City charged monthly rent for the use of the space to sell lottery and Nevada tickets. Interest was to be paid on amounts owing if rent was not paid by the 15th of the month. The interest rate was 1.25% monthly. | The City charged nothing for the space used to sell lottery and Nevada tickets. The clause regarding interest on amounts owing was removed. |

| Contract Terms That Are Similar Between Both Contracts | |
|---|---|
| Tickets sold on consignment | The Company was contracted to sell Transit tickets on consignment. |
| Reconciliations | Ticket sales were to be reconciled and payments made to the City prior to replenishing the kiosk with more tickets. |
| Payments due to the City | Payments to the City were to be made by the 5th of each month. |
| Right to audit books | Proper books and records were to be maintained. The City had the right to audit the books. |
| Annual gross revenue | At the end of each year, the Company was to submit the amount of annual gross revenue. |
| Vending machines | The Company was not permitted to operate vending machines. |
| Coin machine | The operation and maintenance of the coin machine was the same. |
| Insurance | General liability Insurance was required. The amount of insurance coverage did increase from $2 million to $3 million. |

## TRANSIT CAFÉ

The initial contract was awarded in May, 1997 with an expiry of April 30, 2002. A new contract was signed on April 1, 2003 between the City and 1211250 Ontario Inc. carrying on business as Zio's Café. The initial term of this contract was to expire on March 31, 2005; however, the lease term could be extended for a period of 1 year, for a maximum of four successive extension terms. Furthermore, if the café continued to occupy the space after the expiration of the lease, they would be a monthly tenant.

The contract expired on March 31, 2009 and was being held over

on a monthly basis until operations ceased on September 4, 2009. The City had not issued a request for proposal (RFP) as of the date operations were terminated. The café has been replaced by vending machines which are under City management.

## AIRPORT CAFÉ

The airport café began operating July 1, 2000 under the name Tailwinds Café. The latest contract was signed on Oct 1, 2003 and expired on September 30, 2007 with the ability to extend the contract on a yearly basis for a period of two years. On Oct 1, 2007, there was a lease extension agreement which extended the lease to December 31, 2009.

The agreement and the extension were between the Sudbury Airport Community Development Corporation and 1447395 Ontario Inc. Around January 2008; Tailwinds Café began operating under 1211250 Ontario Inc.

Airport management was not completely satisfied with the current operation of the café. As a result, prior to the café closing, airport management had already contacted Purchasing in preparation for issuing another RFP when this contract was up.

# AUDIT RESULTS

## A. CONSIGNMENT OF TRANSIT TICKETS / PASSES

The $866,000 cash kept by 1211250 Ontario Inc. represented cash proceeds of approximately $420,000 bus tickets, or 14.5% of total Transit Operating Revenues in 2009

According to the 2004 contract, Transit tickets and passes (tickets) were provided to the Company on consignment. The $866,000 of cash owed by the Company represented the cash proceeds for approximately 420,000 bus tickets released on consignment, or 14.5 percent of Total Transit Operating Revenues in 2009.

Tickets were sold for cash

As with any contract, it is imperative that management identify the risks in the contract, both when the contract is entered into and throughout its term, and manage these risks accordingly. Transit ticket sales are high volume cash sales. Cash is easily diverted and highly susceptible to fraud and/or misappropriation. With the balance of the unremitted ticket proceeds growing over the years, management should have investigated options to (1) prevent this amount from increasing, and (2) reduce the unremitted amounts in order to reduce the risks to the City, and should have taken appropriate action.

Contract terms were not followed

Reconciliations for tickets sold to the Company were not performed as per the contract terms

Additional tickets were advanced without obtaining payment for previously advanced tickets

Management did not administer the contract according to its terms. The contract required that cash from all ticket sales be reconciled by the 25th day of each month and payment for these tickets be made to the City by the 5th day of each month, prior to the delivery of additional tickets. However, management repeatedly advanced tickets to the Company without first obtaining payment for the previously advanced tickets. This increased the risk to the City. Since tickets were released on consignment a few times a month, there would have been a steady stream of cash generated from these sales. Also, with management's efforts to collect the amounts owing being unsuccessful, the Company was in effect, borrowing these monies interest free. The amount outstanding exceeded $1.1 million in March, 2009.

Although there were other available methods to protect these cash proceeds from significant loss, those methods were not identified and

Alternatives for collecting monies owed to the City were not considered

adopted by management.

- The City's cash could have been directly deposited to the City's bank account by the Company on a daily basis; or
- The City's cash could have been collected from the Company on a daily basis, and directly deposited to the City's bank account.

The Company as well as City management failed to safeguard public assets

Further steps were available to management that would have allowed them to determine the likelihood, and extent of the City's risk.

The City should have ensured that the company would segregate its cash and return it to the City frequently. Receivables collection policies and procedures exist in order to minimize risk. Managers are expected to understand and mitigate these risks, making all reasonable efforts to collect outstanding debts. Further steps were available to management that would have allowed them to determine the likelihood, and extent of the City's risk.

It is not known where the missing ticket cash proceeds went and where they are today.

Recommendations:

1. Before the City enters into a contract, City management should identify risks in drafting the contract and take care to mitigate these risks. This may include consulting with other departments within the City such as Finance, Legal, the Auditor General's office, etc., and outside legal experts in drafting particular kinds of contracts.
2. Departmental management should be required to ensure that all contracts are managed and performed according to their terms.

## B. ACCOUNT RECEIVABLE MANAGEMENT

Sound receivable management minimizes the time between a sale and the cash collection for that sale

According to the City's policy on accounts receivables and collections, "the fundamental rule of sound receivable management is to minimize the time between a sale and the cash collection for that sale. The longer it takes to collect the cash owed for the provision of goods or services, the greater the risk that amounts owed will become uncollectible." Furthermore, "the collection of accounts receivable is a shared responsibility between the operating department and accounts receivable."

The collection of accounts receivable is a shared responsibility between the operating department and accounts receivable

Staff and management were aware of the large outstanding receivable

Many levels of City staff and management within the Growth and Development and Finance departments were certainly aware of the large outstanding receivable in the 22 month period leading up to the termination of the Kiosk Agreement. (December 2007 to September 2009). The City process included the preparation and review of a monthly, aged listing of all outstanding receivables that was to be reviewed by Accounts Receivable and Transit Services.

Departments receive monthly aged listing of accounts receivable for their area

In a draft report to management, KPMG identified the risk of having such a large receivable outstanding (in excess of $800,000), and that there was no active follow-up by management on the overdue receivable

In December 2007, KPMG (the City's external auditors) undertook a review of the revenue and receivable processes at Transit. In the draft report, KPMG provided the following as background "In December 2007 KPMG as part of there audit of the City of Greater Sudbury visited the administrative office of Sudbury transit to review the revenue and receivable process. Because of control deficiencies observed during that review, KPMG issued a management letter dated January 21, 2008 outlining the control deficiencies and recommending the implementation of certain polices and practices.

On February 6, 2008, Greater Sudbury Transit engaged KPMG to further review the office procedures and assist with the development of financial reporting and monitoring procedures relating to inventory of ride cards and passes (including consignment inventory) and related unearned income."

KPMG's report to management was only received in DRAFT

From this consulting assignment, KPMG drafted a report to Transit management in which they expressed their concerns regarding the large outstanding receivable. The report stated that "While KPMG was in attendance at Transit it became known that one

of the vendors was in arrears in excess of $800,000. It was clear that there was no active follow-up on overdue receivables. Transit should make arrangement with Finance to get a monthly listing of accounts receivable and actively follow-up with collections of outstanding amounts. The Supervisor could be assigned this task." The City never requested, nor received a final copy of this consulting report.

One full time Transit employee was added in order to implement new financial control procedures

In May 2008, a Request for Decision regarding Transit Administration Staffing was presented to Council. It asked for the authorization to create one permanent full time Cashier position in order to implement new financial control procedures as a result of the control deficiencies identified by KPMG in December 2007. The position was created and filled.

Management maintains that the Company would always come current with monies owing to the City. However, since July 2007, the account was never current

As of September 4, 2009, all amounts owed from April 28, 2009 onward were outstanding

During the Transit audit Finance and Transit management stated that the Company would temporarily fall behind in paying the City, but would always come current when so requested by City management. However, a review of the aged account receivable listing revealed that since July 2007, the account was never current. As of September 4, 2009, all amounts owed from April 28, 2009 onward were outstanding.

Exhibit 1 (below) shows the aging of the account for each quarter from September 2004 to September 2009.

Exhibit 1

| | Number of Days Overdue | | | | | |
|---|---|---|---|---|---|---|
| | Current | 31-60 | 61-90 | 91-120 | Over 120 | Total |
| 30-Sep-04 | 214,570.00 | | | | | 214,570.00 |
| 31-Dec-04 | 142,459.00 | | | | | 142,459.00 |
| 31-Mar-05 | 166,843.00 | | | | | 166,843.00 |
| 30-Jun-05 | 254,401.00 | | | | | 254,401.00 |
| 30-Sep-05 | 225,398.00 | | | | | 225,398.00 |
| 31-Dec-05 | 363,302.60 | | | | | 363,302.60 |
| 31-Mar-06 | 112,000.00 | | | | | 112,000.00 |
| 30-Jun-06 | 191,986.00 | | | | | 191,986.00 |
| 30-Sep-06 | 248,467.00 | | 12,250.00 | 124,986.00 | | 385,703.00 |
| 31-Dec-06 | 369,108.00 | | | | | 369,108.00 |
| 31-Mar-07 | 387,634.00 | | | | | 387,634.00 |
| 30-Jun-07 | 428,578.00 | | | | | 428,578.00 |
| 30-Sep-07 | 195,941.50 | 179,600.00 | 206,276.50 | | | 581,818.00 |
| 31-Dec-07 | 282,700.00 | 227,500.00 | 176,650.00 | 13,500.00 | 150,251.50 | 850,601.50 |
| 31-Mar-08 | 349,166.00 | 49,300.00 | | 48,100.00 | 196,051.50 | 642,617.50 |
| 30-Jun-08 | 299,725.00 | 130,775.00 | 174,043.25 | 165,525.00 | | 770,068.25 |
| 30-Sep-08 | 229,750.00 | 168,800.00 | 317,100.00 | | | 715,650.00 |
| 31-Dec-08 | 291,225.00 | 243,700.00 | 239,950.00 | 87,425.00 | | 862,300.00 |
| 31-Mar-09 | 406,050.00 | 227,774.00 | 95,275.00 | 195,950.00 | 207,675.00 | 1,132,724.00 |
| 30-Jun-09 | 246,850.00 | 57,600.00 | 277,700.00 | 192,950.00 | 144,974.00 | 920,074.00 |
| 30-Sep-09 | 32,503.00 | 192,500.00 | 209,200.00 | 181,000.00 | 80,200.00 | 695,403.00 |

The balance of this receivable grew continuously. It did not suddenly appear over a period of a month and a half as Management has stated to the Auditor General's Office

The above quarterly review of the aged receivables shows a clear pattern of growth in the outstanding balance up to the point where the contract was abruptly ended.

Overdue billing advices would carry over month after month with no collection. This is illustrated by the examples highlighted below in Exhibit 2.

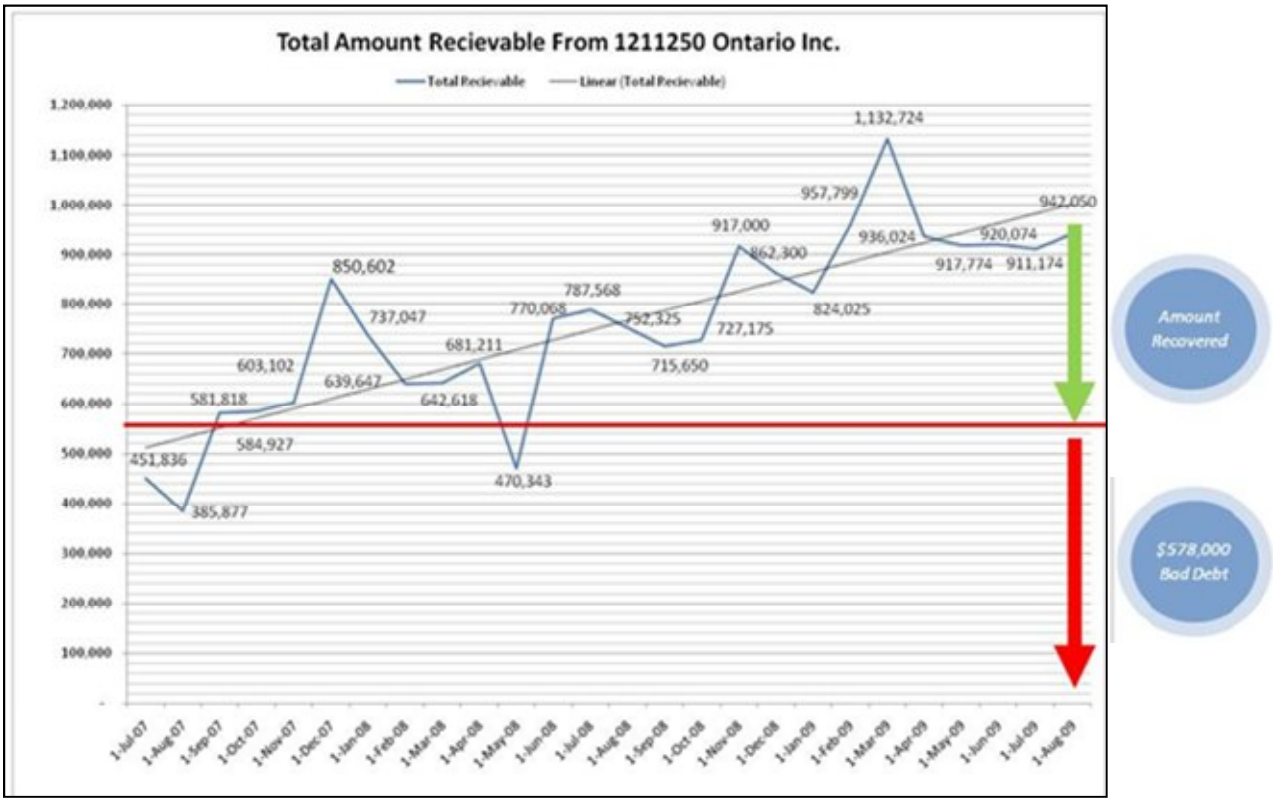
Exhibit 2

1211250 Ont Inc
Aged AR Listing

| Date | Total Recievable | Current | 31-60 | 61-90 | 91-120 | 120-9999 |
|---|---|---|---|---|---|---|
| 31-Jul-07 | 451,836 | 226,277 | 225,559 | | | |
| 31-Aug-07 | 385,877 | 179,600 | 206,277 | | | |
| 30-Sep-07 | 581,818 | 195,942 | 179,600 | 206,277 | | |
| 31-Oct-07 | 584,927 | 355,375 | 13,500 | 117,000 | 99,052 | |
| 30-Nov-07 | 603,102 | 262,700 | 176,650 | 13,500 | 117,000 | 33,252 |
| 31-Dec-07 | 850,602 | 282,700 | 227,500 | 176,650 | 13,500 | 150,252 |
| 31-Jan-08 | 737,047 | 232,795 | 126,500 | 227,500 | | 150,252 |
| 29-Feb-08 | 639,647 | 217,895 | 177,600 | 48,100 | 95,800 | 100,252 |
| 31-Mar-08 | 642,618 | 349,166 | 49,300 | | 48,100 | 196,052 |
| 30-Apr-08 | 681,211 | 227,593 | 349,166 | 49,300 | | 55,152 |
| 31-May-08 | 470,343 | 130,775 | 174,043 | 165,525 | | |
| 30-Jun-08 | 770,068 | 299,725 | 130,775 | 174,043 | 165,525 | |
| 31-Jul-08 | 787,568 | 317,100 | 165,650 | 130,775 | 174,043 | |
| 31-Aug-08 | 752,325 | 168,800 | 317,100 | 135,650 | 130,775 | |
| 30-Sep-08 | 715,650 | 229,750 | 168,800 | 317,100 | | |
| 31-Oct-08 | 727,175 | 239,950 | 148,600 | 168,800 | 169,825 | |
| 30-Nov-08 | 917,000 | 359,650 | 239,950 | 148,600 | 168,800 | |
| 31-Dec-08 | 862,300 | 291,225 | 243,700 | 239,950 | 87,425 | |
| 31-Jan-09 | 824,025 | 158,650 | 195,950 | 243,700 | 225,725 | |
| 28-Feb-09 | 957,799 | 349,674 | 95,275 | 195,950 | 243,700 | 73,200 |
| 31-Mar-09 | 1,132,724 | 406,050 | 227,774 | 95,275 | 195,950 | 207,675 |
| 30-Apr-09 | 936,024 | 330,250 | 300,650 | 227,774 | 77,350 | |
| 31-May-09 | 917,774 | 141,300 | 277,700 | 334,375 | 164,399 | |
| 30-Jun-09 | 920,074 | 246,850 | 57,600 | 277,700 | 192,950 | 144,974 |
| 31-Jul-09 | 911,174 | 286,950 | 181,000 | 57,600 | 277,700 | 107,924 |
| 31-Aug-09 | 942,050 | 216,550 | 209,200 | 181,000 | 57,600 | 277,700 |
| 30-Sep-09 | 695,403 | 32,503 | 192,500 | 209,200 | 181,000 | 80,200 |

Exhibit 3 (below) graphically displays the growth in the receivable balance.

Exhibit 3




The amount owing the City was at its highest in March 2009 with the Company owing the City over $1.1 million

In March 2009, the receivable was at its peak, with the Company owing the City over one million dollars. The City provided the Company with approximately $2.4 million worth of tickets each year. Since tickets were sold for cash and the Company was paid its fee monthly in any event, it was unnecessary for the Company to hold City funds for any length of time.

At each renewal of the contract, the balance owing from the Company was carried over

The original contract with 1211250 Ontario Inc. ended on January 31, 2004. A new contract was signed on June 1, 2004 which ended on January 31, 2006. The contract was extended year after year for three consecutive years. At each holdover period, substantial amounts were owed to the City. The Auditors acknowledge that some of these balances will have been ticket inventory. At termination of the

contract, the on-hand ticket inventory was found to be $96,000.

Exhibit 3 (below), illustrates the balances owing to the City at key dates within the contract.

| Date | Event | Amount Owed to City |
|---|---|---|
| January 31, 2004 | Contract ended | $142,739 |
| June 1, 2004 | New contract started | $262,206 |
| January 31, 2006 | Contract ended | $340,845 |
| January 31, 2007 | End of 1st year renewal | $333,962 |
| January 31, 2008 | End of 2nd year renewal | $504,252 |
| January 31, 2009 | End of 3rd year renewal | $824,025 |
| September 4, 2009 | Contract terminated | $866,537 |

There was ample opportunity for management to develop a strategy for collection

As the trend worsened over several years, there was ample opportunity for management to develop a strategy for collection. The current account receivable policy does provide management options in collecting outstanding receivables, however, the Auditors could not find evidence that any of these methods for collection were used.

The Auditors could not find evidence that any formal methods for collection were used

Although both City management and the vendor were clearly not following the original terms and conditions of the contract, there was no attempt by management to change the contract terms at any of the renewal dates to ensure that the City received the monies owing.

Terms of the contract were not being followed

Finance management has suggested to the Auditors that many of the contract terms were never followed since the date the tender was awarded in 2004. If the contractor and/or the City have found that that they could not operate in accordance with the terms of the contract, the normal commercial practice is either to amend the contract or to terminate it.

Recommendations:

3. To obtain full value for money, the City should ensure it receives a final copy of all consultants' reports where draft reports are provided. These reports should be disseminated to appropriate staff.

4. When a contract is extended or renewed, the City should

ensure that it is not owed any money unless such debt is specified in the contract. Additional contracts should not be awarded if the company owes the City money.

5. Contracts should not be extended or renewed if the terms and conditions of the original contract have not, or can no longer be followed.

6. Management should ensure that the City's policies, procedures and bylaws regarding contracts and cash remittances are followed. If there is an exception to these policies, procedures or bylaws, it should be clearly documented and the appropriate approvals received.

## C. ACCOUNTS RECEIVABLE COLLECTION PROCEDURES

The City's Accounts Receivable and Collections policy clearly outlines the process for collecting overdue accounts. Demand letters are sent out at specific intervals when an account is past due. Letters progress from gentle reminders to very persistent letters as accounts become more past due.

According to City policy, the first letter is sent out at the end of the second month the account is past due. The second letter is sent out at the end of the third month the account is past due, and the third letter is sent out after the fourth month the account is past due. The third letter gives the debtor 15 days to make a payment or the amount is sent to a collection agency or transferred to the tax roll.

If payments are still not received, the Supervisor of Accounts Receivable can make other recommendations to collect the account. This can include processing a credit invoice through the Accounts Payable system to retrieve the funds from amounts owing to the customer, negotiating terms of payment, etc. Even though management was having difficulty in collecting the amounts owing, management did not take firm and timely action in trying to collect this

Even though management was having difficulty collecting on the account, they did not take firm and timely action in attempting to collect the funds

account.

Accounts Receivable policies and procedures were not followed in attempting to collect the funds owed to the City

The accounts receivable policy setting out collection letters did not come into effect until 2009. Prior to this the City's method of notifying customers of overdue accounts was to send a statement with an overdue label affixed to the statement. With the implementation of the PeopleSoft Accounts Receivable module, collection efforts are now recorded in a conversation field that is embedded in the software. Management stated that they would speak to the Company regarding the funds owed to the City. There is no documentation regarding the frequency or content of any such conversations.

Notice of Default letter was issued by the City

In August 2009, management did attempt to collect the monies owed. The City's Transit department issued a Notice of Default letter to the Company on August 31, 2009. The Notice of Default gave the Company two days to pay the balance owed to the City. On this date, the receivable outstanding was $832,050. The Company agreed to bring the account "current" by September 10, 2009. In attempting to do so, the Company provided the City with post dated cheques.

Even though the City was having difficulty collecting on the balance owing, they continued to issue Transit tickets to the Company

Although the City was attempting to collect monies from the Company and issued a Notice of Default letter on August 31, 2009, the next day (September 1, 2009) Transit issued $22,750 worth of tickets to the Company. When the City took over operations on September 4, 2009, the City recovered $96,000 worth of unsold Transit tickets.

Recommendations:

7. Once an account is significantly overdue, no further business should be conducted that would increase the amount owing to the City. Management should make all attempts at safeguarding public funds in such risky situations.

## D. ESTABLISHING CREDIT LIMITS

No credit limit was placed on the account for 1211250 Ontario

According to City policy, the Directors in "the operations where

Inc.

credit is extended are responsible for establishing credit limits for regular users." Credit limits are to be "established by the Directors in consultation with Finance." No credit limit was placed on the account for 1211250 Ontario Inc. Management was relying on the existing $75,000 letter of credit as a safeguard against any non compliance of the contract.

Other risk factors should be considered in determining the amount of the letter of credit

When a letter of credit is used, the operating department and the Purchasing department determine the amount of the letter of credit. According to the Purchasing department, the letter of credit is usually 10% of the value of the contract. However, other factors need to be considered in setting the amount.

Between 2005 and 2008, annual ticket sales at the Transit Kiosk were approximately $2.4 million. Since the contract was a three year contract, 10% of the value of the contract would require a letter of credit of approximately $720,000. Although this may appear unreasonably high, other factors should be considered in determining an amount. Risks such as collectability of the account, average balance in the receivable as well as any operational risks associated with the contract should be considered.

The letter of credit was insufficient to cover one month's worth of tickets held on consignment at the Transit kiosk

With over $150,000 worth of tickets provided to the Company on a monthly basis, the $75,000 letter of credit was insufficient to cover the value of one month's worth of tickets. Although hind-sight is 20:20, a requirement for daily cash deposits into the City's bank account would likely have eliminated that portion of risk.

Recommendations:

8. Where appropriate, credit limits should be reviewed and established on accounts receivable.

9. Management should consider developing a new policy for determining the amount of the letter of credit. For example, the value of the contract as well as other risks (financial, operational, etc.) should be considered in establishing an amount for the letter of credit. The policy should consider instances where exceptions are made, how these exceptions

are documented and what approvals are necessary.

10. When letters of credit are used, they should be reviewed when contracts are extended and renewed, and changes made as required. Having the ability to review and make changes to the amount of a letter of credit must be included as part of the terms of the contract. If a letter of credit to an acceptable amount cannot be secured, other controls should be put in place to ensure collectability of City funds.

## E. INTEREST CHARGES

Amounts in arrears over 30 days are subject to interest charges in accordance with the City's Accounts Receivable and Collections Policy

According to the City's Accounts Receivable and Collections policy, "amounts in arrears (over 30 days) will be subject to interest charges, as established by the User Fees bylaw".

Charging interest on overdue amounts was not specified in the 2004 Kiosk Contract

Charging interest on overdue amounts was specified in both the Transit Café and the Airport Café lease contracts, but not the 2004 Transit Kiosk contract. However, charging interest on overdue accounts is both a City policy as well as established through the user fee bylaw.

There was no documented evidence where not charging interest was approved by the Chief Financial Officer and Treasurer

No interest was paid for amounts in arrears under the Transit Kiosk contract. Furthermore, Audit could not find any documented evidence where the "exception" in not charging interest, was formally approved by the Chief Financial Officer and Treasurer in accordance with the User Fees Bylaw.

If the 2004 Kiosk contract would have provided for the City to charge interest in accordance with the User fee Bylaws on the overdue amounts between September 2004 and September 2009, the amount owing would have increased by approximately $214,000 of interest.

If the interest rate set out in the User Fee Bylaw can now be charged against that entire balance, applying the interest rate specified in the User Fee Bylaw, would result in an additional interest charge of approximately $252,000. Potential interest charges would then have totalled approximately $466,000 as of May 31, 2011.

Recommendations:

11. If the City pursues any further collection attempts on the receivables owing, the City should attempt to collect the full amount of interest payable on the account.

12. In managing contracts, the City should ensure that all of its policies, procedures and by-laws are followed. Contracts should be written to ensure that they comply with the City's policies, procedures and by-laws. Any exceptions should be clearly noted and approved by Council.

## F. UNAUTHORIZED PAYMENTS TO AN INDIVIDUAL

No manager is authorized to pay any person, whether an individual or a company, for services invoiced when that person has not provided those services. Under the written agreement between the City and the Company 1211250 Ontario Inc., each month the City was obligated to pay the Company a management fee to operate the Transit Kiosk. The City and the Company were the only parties to the agreement. Therefore, these Transit Kiosk management fees should have been paid to the numbered Company, and to no one else.

In the City's computerized Accounts Payable system, which uses PeopleSoft software, two vendor files were set up for 1211250 Ontario Inc. within the vendor master file. However, other vendor files were also set up within PeopleSoft to deal with the many different company names provided to the City for payment. Invoices requesting payment of management fees for the transit kiosk referred to the following names without reference to the numbered Company.

Multiple vendors were set up in the vendor master file

- Zio's Café (1211250 Ontario Inc. legally registered business name)
- Zio's Tuck Shop
- Zio's
- FalconWings Ltd.

Some management fees were paid to these other names when the

City was invoiced through their business names, even though there was no contractual relationship between these companies and the City. There was no contractual basis, hence no authority to make such payments.

Management fees were paid on invoices from various Company names

| VENDOR NAME | VENDOR NUMBER | PAYEE NAMES FOR MANAGEMENT FEE | | | | |
|---|---|---|---|---|---|---|
| | | PERSONAL NAME OF DIRECTOR | ZIO'S CAFE | ZIO'S TUCK SHOP | FALCON WINGS LTD | ZIO'S RUNWAY CAFE |
| 1211250 ONTARIO INC | 0000002415 | [redacted] | [redacted] | [redacted] | | |
| 1211250 ONTARIO INC | 0000018594 | | | | | |
| FALCONWINGS LTD | 0000015314 | | | | [redacted] | |
| ZIO'S RUNWAY CAFE | 0000003558 | | | | | [redacted] |

Between January 2004 and September 2009, the majority of funds (70%) were paid personally to this individual

| NAME OF PAYEE | AMOUNT PAID |
|---|---|
| The individual (Company Director) | $533,506 |
| Zio's Cafe | $70,438 |
| Zio's Tuck Shop | $116,848 |
| Zio's Runway Cafe | $47,172 |
| Falcon Wings | $10,700 |

Invoices were paid directly to an individual (not the numbered Company)

However, a larger portion of the management fees were not paid to any company, but to an individual. Most invoices for the monthly management fees were submitted as Zio's Cafe. On these invoices, where the invoice form had a space in which to indicate the name of the person to whom the cheque should be made payable, the printed text said Zio's Café. However, this printing was crossed out by hand, and in handwriting it was indicated that the cheque should be made payable to one of the Directors of the Company personally. Just as there was no contractual basis for paying that company, there was no contractual basis for paying the individual personally, hence no authority to make such payments.

The reason why the money was paid to the individual was because the invoices were approved for payment to this individual.

The reason why the money was paid to the individual was because the invoices were approved for payment to this individual. The first cheques payable to the Director of the Company personally were written in October 2005. Payments to the Director of the Company continued for almost 4 years, until kiosk management services were discontinued in September 2009.

$533,506 of cheques made payable to this individual were deposited in a personal bank

Furthermore, when these cheques payable to the Director of the Company were deposited at the bank, they were deposited directly into a personal bank account. Thus, it was the Company Director who

account

received the benefit of the contract rather than the contracting party, the Company.

The Auditor General obtained independent legal advice on this point. The Auditor General's legal counsel advised that "It is likely that civil fraud or other actionable wrongdoing has occurred" if the Company Director(s) who received the benefit of the management fees, also controlled the disposition of the missing Transit Revenues. Generally Accepted Government Auditing Standards require the Auditors to report their findings when any kind of fraud or misconduct may have occurred.

The City's efforts to recover the unremitted proceeds of ticket sales have been limited to the numbered company

The City's efforts to recover the unremitted proceeds of ticket sales have been limited to the numbered company. This lawsuit was not defended by the Company. However, the amount recovered from the Company was considerably less than the unremitted proceeds of the ticket sales. As the contract with the City provided no legal basis for either the Company or any of its Directors to keep the proceeds of the sale of the City's transit tickets for themselves, the Auditor General has been unable to determine any equitable or legal basis for the Company Director(s) to claim that the City's money was theirs to spend. The Auditors have asked City management to explain why, if the Company Director(s) received the financial benefit of the contract personally, they should not also bear the contractual burden of repaying the Taxpayer's money. To date, no clear and compelling explanation has been received as to why the lawsuit against the Company was not expanded to include the Company Director who received the payments personally, or alternatively, why that individual was not sued in a separate lawsuit.

Ontario's Limitations Act imposes a statutory time limit to commence legal proceeding which is 2 years

Ontario's Limitations Act imposes a statutory time limit within which to sue. It is 2 years after the cause of the lawsuit arises. After that date has passed, unless the City could prove that it was unaware that it had the right to sue, the City would likely have no further ability to sue the individual to recover its money. The cost to preserve the City's ability to recover the money through a civil claim is estimated to be approximately $5,000.

The authority of management to release or withhold invoices for payment is a key control within the accounts payable process.

Management's review and signing of invoices is a key control within the accounts payable process

Management needs to be prudent with the invoices they are signing, particularly with recurring invoices that continue to be submitted over several years, since once management signs an invoice, accounts payable will make the payment to the named payee, in the amount indicated on the invoice.

In order to have cheques made payable to the individual, an alternate payee was sent up in the vendor file in PeopleSoft

In order to have the cheques made payable to the individual, an alternate payee was entered in the City's vendor master file. Once an alternate payee was set up, all future cheques produced under that vendor were made payable to the alternate payee.

The cost centre reports will show the vendor name in PeopleSoft, not the alternate payee name

With limited controls over alternate payees, there is an increased risk of fraud

When an alternate payee is used, the City's cost centre reports will show the expense associated with the name of the vendor, not the alternate payee. Cost centre reports are used by management to review the costs in their area. When management reviews these reports, unless they authorized the alternate payee, they would be unaware that the expense was paid to an alternate company/individual. Having weak or limited controls over the ability to change the alternate payee field increases the risk of fraud.

Two other vendors are set up with alternate payees that are individuals

Total cheques paid to these other two individuals totaled $61,000

The Auditor General's Office used ACL (computer based auditing software) to determine whether there were any other vendors set up with an alternate payee, where the alternate payee was an individual rather than the Company. Audit sampled all invoices paid between January 1, 2008 and October 31, 2010. Testing revealed that there were two other vendors set up where the alternate payee was an individual. Total cheques written to these alternate payees were $61,000. These were related to other departments and details have been provided to the Finance department.

Historical information is compromised when changes are made to the vendor master file

When a change is made in the vendor master file, all historical information is also changed. For example, if the vendor master file is updated with a name change, any report run after the change is made will contain the updated information. Therefore, the accuracy of historical information is compromised.

Recommendations:

13. Management should ensure that invoices are paid only in

accordance with the contract and, more specifically, to the proper legal entity. No manager is authorized to initiate payments to a legal entity (an individual or a company) for services received, when that legal entity has not provided those services.

14. Controls over access to the alternate payee field needs to be reviewed to ensure that there is limited access. Access to the alternate payee field should only be permitted when there are legal documents to support the change, as approved by the City Solicitor.

15. An exception report should be developed which management can review that would indicate where the payee on the cheque is different than the name on the vendor master file/contract.

16. When City Solicitor authorized changes are required to the name on the vendor master file to reflect any necessary amendments to the contract, Accounts Payable should inactivate the existing vendor and set up a new vendor with the proper information. This way, the accuracy of historical information is maintained.

## G. MANAGING THE TERMS OF THE CONTRACT

Various terms within the Transit Kiosk, Transit Café and Airport Café contracts were not followed. Some of these resulted in monies lost to the City, others had no monetary impact. Those that had a monetary impact are explained below.

Erroneous Payments

The Company did not pay for the Transit tickets until they were sold. Once the tickets were sold, these monies were required to be

remitted to the City with the monthly reconciliation.

Approximately $18,000 was paid to the Company in error for tickets returned

Approximately $18,000 was paid to 1211250 Ontario Inc. for tickets returned to the City. The Company was billed for these tickets and the revenue recognized by the City. The City should have processed a credit invoice against the account receivable rather than issue a cheque. These invoices were approved by Transit management for payment.

Monthly Management Fees

The City overpaid the monthly management fee for the Transit Kiosk by $2,533 between 2005 and 2008

Under the terms of the Transit Kiosk contract, monthly management fees increased February 1st of each year. However, January invoices for management fees were submitted to the City by the vendor at the next year's increased amount. Therefore, each January the City overpaid on the contract. These invoices were approved by Transit management. These overpayments totalled $2,116 for invoices dated between January 2005 and January 2008.

$22,500 in duplicate management fees were paid

In 2004, $22,500 of duplicate management fees were paid. Management had already set up an automated prepayment process to ensure the management fees were paid on time. For five months starting in January 2004, the Company submitted, and Transit management authorized invoices for (duplicate) payment of those same management fees.

Payment of a Percentage of Gross Revenue

15% of gross revenue was not obtained from the Company

Under the terms for both the Transit Cafe and the Airport Cafe lease agreements, the Company was to pay 15% of its gross revenue each month, less the amount payable as minimum rent. Monthly statements showing gross revenue was to be provided to the City. Furthermore, the Company was to submit audited statements within 120 days of the end of each fiscal year. The contracts provide the City with the right to audit the financial records of the Company after termination of the contract.

Transit management did not obtain monthly or annual documentation in order to calculate whether any monies were owed to the City

Transit management did not request or obtain either monthly or annual statements in order to calculate whether any monies were owed to the City as a percentage of gross revenue. As a result, the auditors could not determine whether any monies were owed to the City.

Although Airport management calculated the revenues owed to

The Airport Cafe requested, and did receive monthly gross revenue

the City based on a percentage of gross revenue ($8,000), the Company was never billed and therefore, monies were not collected

amounts at the end of each fiscal year; however these were not audited figures. Although the Company submitted annual gross revenue for the Airport Cafe to the Finance Department, the Auditor General's Office discovered that the City never did bill the Company for these revenues. The lost revenue from 2004 to 2009 at the Airport was approximately $8,000. This loss was in addition to the minimum rent.

Property Taxes

For both the Transit Cafe and the Airport Cafe, the City was to bill and collect property taxes. The City did this under the Airport Cafe contract, but not the Transit Cafe contract.

Potential lost revenue for not billing for a portion of commercial property taxes at the Transit terminal is approximately $17,000

Based on the information Audit was able to obtain, Audit estimates that the commercial taxes recoverable from 1211250 from 2004 to 2009 are approximately $17,000.

Recommendations:

17. In order to simplify lease administration and reduce the risk of payment errors, the City should develop a system to flag when lease and contract renewals are coming due.

18. If any further collection attempts can be made, the City should attempt to recover the missed revenues under the terms of the contracts. Auditing the financial records of the Company would determine the actual amount owing to the City.

## H. CONTRACT MANAGEMENT

Enhance the City's due diligence process in the tendering and awarding of contracts

As part of the City's due diligence in tendering and awarding contracts, processes should be enhanced in order for the City to have a greater knowledge of with whom they are doing business. A formal process should be established to search, collect, document and analyze information on the background, ownership, reputation and integrity of

individuals or entities with whom the City plans to enter into contracts.

The City currently has wording within the Request for Proposal (RFP) that permits the City to reject a proposal or tender based on record and reputation. In order to reject the proposal or tender, circumstances include but are not limited to either past or current litigation with the City, failure to pay all outstanding payments owing to the City, etc. The one shortfall in this clause is that the City needs this information prior to any contract being awarded (information regarding the parties submitting the proposal/tender/bid as well as their history).

Business searches will provide additional information on a company prior to entering into a contract

Business searches can also be done. These searches provide general information on the company, for example, the owners of the company. With numbered companies, it is difficult to know who you may be entering into a contract with. There is a risk that the City may unknowingly enter into contracts with companies and/or individuals with whom they have decided not to do business in the future. These business searches will provide this information however; there is a cost for this service.

The City should be able to make changes that would affect the administration of a contract

Once a contract is signed, the City may not be able to make changes to the administration of the contract unless the right to make administrative changes are specified in the contract. During the term of the contract, there may be administration changes management identifies which would assist them in either managing the contract or safeguarding public funds.

Recommendations:

19. As part of the City's due diligence in awarding contracts, business searches should be considered. The City would need to state in the RFP that the City may request that the vendor submit to a business search prior to the award of the contract. A business search should be mandatory for all revenue generating contracts. Due to the cost of performing such a search, for all other contracts, management should decide and document whether to request that the vendor do a business search.

# I. THE AUDITOR GENERAL'S OFFICE AND ACCESS TO INFORMATION

The Auditor General's office was not contacted regarding the potential substantial loss to the City

Through their review, the Auditor General's Office has determined that there are additional monies owed to the City

It takes many months for the auditors to obtain necessary information to perform the audits

The Auditor General's Office can provide independent review of events and records when a potentially substantial financial loss for the City is evident. Through our review we have determined that there were other monies owed to the City that were not recognized by management at the time the City made the initial claim against 1211250 Ontario Inc.

Although the Auditor General's Office has seen significant improvements in access to information in the recent past, the office was not initially informed of this situation, and was not always able to obtain access to information on a timely basis. Not having access to information can either prolong the audit or the auditor may not have all the information necessary to make the best recommendation for the department/organization.

In the spring of 2010, the Auditor General requested a copy of the contract between the City and 1211250 Ontario Inc. from Transit Services, Legal Services and the City Clerk's office. We were told that a copy of the signed contract could not be located. An incomplete version of the signed contract was eventually obtained during an interview with Finance in December 2010. A complete copy of the contract was eventually obtained from the City Clerk's office in April 2011. On April 18, 2011, the Auditor General had also requested a copy of the contract between 1211250 Ontario Inc. and the former City of Sudbury from Transit Services, Purchasing, Legal Services and the City Clerk's office. We were only provided with a copy of this contract on June 16, 2011. It also took many months and the auditors made many requests to obtain a copy of the management letter from KPMG in regards to their review of the revenue and receivable process in Transit Services. A copy of this letter was eventually obtained on June 13, 2011.

Recommendations:

20. The Auditor General's office should be informed when there is a potential substantial financial loss to the City. The Auditor

General can work with management to determine the extent of the loss as well as to recommend improvements to controls intended to prevent similar losses in the future.

21. The CAO should provide direction to staff that would confirm that the Auditor General's office is required by law to be provided with the information it requests in a timely manner.

## CONCLUSION

This report contains 21 recommendations related to improvements in the management of contracts

Our recommendations relate to the need to:

- Improve the quality of contract drafting, management and oversight
- Improve the controls surrounding payment processing and oversight
- Improve the due diligence performed by the City in awarding contracts
- Clarify the application of the User Fee Bylaw related to the recovery of interest on overdue amounts owed the City

Implementing the recommendations contained in this report will strengthen controls. It will also improve management's ability to manage contracts and make necessary changes in order to safeguard public funds.

SUMMARY 1

| SUMMARY OF DECISIONS REFLECTING THE QUALITY OF SAFEGUARDING OF PUBLIC ASSETS | | |
|---|---|---|
| Event/Decision | What Happened | What Should Have Happened |
| 2004 Kiosk Management Contract - Negotiation | Dropped 1.25% late interest clause and the $500 NSF fee | User Fee Bylaws require a 1.25% monthly late interest charge and a $38 NSF fee. |
| 2004 Kiosk Management Contract - Duplicate payment of management fees | Total management fees exceeded contract amount for the year. | A review of financial operating expenses should have triggered the recovery of the duplicate payments. |
| Kiosk Management Contract - Ticket sales were to be reconciled. | No reconciliations were performed. | Monthly reconciliations for the tickets sold on consignment should have been done. |
| Kiosk Management Contract - Payments made to the City prior to the City replenishing the kiosk with more tickets. | Additional tickets were provided to 1211250 Ontario Inc. without first obtaining payment for previous tickets provided. | No additional tickets should have been provided to the contractor until payment for previous tickets were received. |
| Kiosk Management Contract - Payments to the City were to be made by the 5th of each month. | Payments were not made to the City on a regular basis, nor did audit find evidence of management attempts to collect by the 5th of each month. | Management should have ensured the terms of the contract were followed and payments made by the 5th of each month. |
| Airport and Transit Cafe Contracts - At the end of each year, the Company was to submit the amount of annual gross revenue. | The Airport Café was the only operation that submitted gross revenue. However, these monies owed to the City were not billed nor collected. Annual gross revenue was not submitted to the City for the Transit Café. | Annual gross revenue for both cafés should have been submitted to the City. The City should have ensured that monies owed to the City were billed to the operator and collected. |
| Airport and Transit Cafe Contracts - At the end of each year, the City was to estimate and recover the amount of annual | The Airport Café was the only operation that estimated and recovered property taxes annually. Annual property taxes | Annual property taxes should have been recovered for the Transit Café. |

| | | |
|---|---|---|
| property taxes applicable to the Café space used. | were not recovered by the City for the Transit Café. | |
| 2005 Kiosk Management Contract - "modified" invoices were submitted requesting personal direct payment for services provided under contract by a numbered Company | Transit Management initiated the process of making personal payments to the individual as an alternate payee | As the City had no contract with the individual, and the individual had not provided services to the City, payment to the individual should not have been initiated by Staff |
| Interest was to be charged on outstanding receivables in accordance with the User fee Bylaws approved annually by Council that outline Financial Service Fees and Charges. | No interest was charged. | Although the Chief Financial Officer and Treasurer is authorized to reduce or waive fees in Schedule FS-A of the Bylaw, the Auditors did not find evidence that this authorization had been obtained.<br><br>Interest should have been charged since interest is to be charged on late receivables. |
| Kiosk Management Contract and Airport and Transit Cafe Contracts - As per the Account Receivable policies and procedures, the City has the ability to offset monies due to a vendor against monies owed to the City. | No offset was made during the term of the contract. | The monthly payments that were being made to the individual should have been offset against the amount owing to the City |
| Kiosk Management Contract - In February 2008, KPMG informed Transit that follow-up was required in order to collect on the large outstanding receivable. | Although KPMG made Senior Management aware of the extent of outstanding receivables in 2008, collection efforts appear to have been limited to Transit staff making inquiries of Zio's staff. Management was unable to provide the Auditor General with clear documentary evidence that, prior to August 2009, Senior Management had made serious attempts that were likely to be effective in recovering the outstanding funds. | Senior management should have actively followed-up on the collection of the receivable in order to bring the account current<br><br>Furthermore, Senior Management should have ensured that the terms of the contract were followed as the terms specified payments were to be made by the company to the City by the 5th of each month. |
| 2008 Kiosk Management Contract | A review of the account shows ongoing payments. However the | Exercise audit rights as per contract to determine what was happening to the |

| | | |
|---|---|---|
| - Contract renewal | payments were insufficient. | money<br><br>Collect outstanding cash withheld by the Company<br><br>Do not renew existing contract terms |
| Kiosk Management Contract and Café Contracts - The City could have requested audited financial statements from 1211250 Ontario Inc. | The City did not request audited financial statements. | The City should have obtained audited financial statements at the end of each year. |
| Kiosk Management Contract and Café Contracts - The City had the right to audit the books even after termination of the agreement. | The City did not audit the books even after termination of the agreement. | The City should have audited the books. This may have helped identify the extent of this problem much earlier, and reduced the City's exposure to the loss. It may now help determine where the money went. |

6913630.2

*Auditor General's Office*

Management Response

# *2010*

# *Audit Of Greater Sudbury Transit Services*

*Transit Kiosk and Café Contract Management*

*Brian Bigger, C.G.A*

*Auditor General, City of Greater Sudbury*

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| Overall Management Response<br><br>All of the significant information provided in this Auditor General's report has been communicated by Management to Council in regular updates commencing in August 2009. These updates included correspondence from the CAO as well as in-camera reports to Council from both Legal and Finance. The financial loss has also been made public through the media. Management wishes to assure Council that we view the circumstances related to the Transit Kiosk contract and the subsequent loss of monies owing to the City as a very serious matter. All staff who has had an involvement in this matter acknowledges as we did in 2009 that better business decisions could have been made. Staff have and are examining policies and procedures to ensure that the City's internal control framework is strong and working effectively to ensure that the City's assets are safe guarded. | | | | | |
| 1 | Before the City enters into a contract, City Management should identify risks in drafting the contract and take care to mitigate these risks. This may include consulting with other departments within the City such as Finance, Legal, the Auditor General's office, etc., and outside legal experts in drafting particular kinds of contracts.<br><br>Auditor Comments:<br><br>*Departmental signoffs and the Due Diligence process did not work as expected.*<br><br>*The facts show that this contract was not* | | | Management does identify business and operational risks (in accordance with the Due Diligence by-law (2001-296F) and factors appropriate provisions into the language of contracts.<br><br>Departments engage in consultation between departments when contracts are drafted and/or entered into and as appropriate. Where there are multiple department reviews of a contract each department signs off on the contract. | No action required. |

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | *well written and did not accurately reflect the relationship between the City and the Company. To properly mitigate the risk of loss, the sales proceeds should have been deposited on a timely basis into a City bank account instead of the management company's bank account, and that any outstanding amounts were to be held in "Trust".* | | | | |
| 2 | Departmental Management should be required to ensure that all contracts are managed and performed according to their terms. | | | Agreed | Management will undertake a review of the processes and policies and procedures related to contract administration. Timing is to be determined. |
| 3 | To obtain full value for money, the City should ensure it receives a final copy of all consultants' reports where draft reports are provided. These reports should be disseminated to appropriate staff.<br><br>Auditor Comments:<br><br>*When the Auditors attended Transit in our* | | | As per the engagement letter of February 4, 2008, KPMG was engaged by management to provide assistance with the development of cash and ticket handling procedures and train staff in following these procedures. A report was not a requirement of this engagement. What was gained by the City are improved cash and ticket handling procedures. The | No action required. |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | *Cash Handling Audit, we found that improved cash and ticket handling procedures were not documented.*<br><br>*Transit also used the control deficiencies identified by KPMG in a request to Council for the creation of the Cashier position.* | | | effectiveness of these improvements was reported on in the AG's report regarding Cash Handling at Transit.<br><br>When consultants are engaged to provide reports, it is City practice to obtain final copies. | |
| 7 | When a contract is extended or renewed, the City should ensure that it is not owed any money unless such debt is specified in the contract. Additional contracts should not be awarded if the company owes the City money. | | | Agreed. As provided by the Records and Reputation clause in the City's procurement documents, the City can choose not to award a contract if there are large outstanding balances owing to the City.<br><br>Also the Accounts Receivable policy provides for amounts owing to suppliers to be offset by amounts owed to the City. | Staff will review existing policies and enhance business procedures to ensure that these existing controls are effective. |
| 8 | Contracts should not be extended or renewed if the terms and conditions of the original contract have not, or can no longer be followed. | | | See 2 above. | See 2 above. |
| 9 | Management should ensure that the City's policies, procedures and bylaws regarding | | | Although this recommendation is broad, under the terms of this audit it would appear | During 2011, Accounts Receivable Supervisor and the Manager of |

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | contracts and cash remittances are followed. If there is an exception to these policies, procedures or bylaws, it should be clearly documented and the appropriate approvals received.<br><br>Auditor Comments:<br><br>*The contract did not exclude interest. It was silent on this point, however, it is encouraging to note that interest is being charged in accordance with the By-law on all active City customers accounts.* | | | to refer to the Accounts Receivable and the User Fee By-law. With respect to this policy and by-law refer to the response in Item 11 below.<br><br>Further, the contract excluded interest, and the approval of the Chief Financial Officer was not required. | Accounting reviewed all active City customers accounts to ensure that interest is being charged in accordance with the By-law. |
| 7 | Once an account is significantly overdue, no further business should be conducted that would increase the amount owing to the City. Management should make all attempts at safeguarding public funds in such risky situations. | | | It is not the City's normal practice to extend further credit to customers who have significant overdue amounts owing.<br><br>Payments were received on a regular basis, but they were insufficient. Finance management and Transit management had regular discussions regarding this account and collection efforts were on-going.<br><br>In the period from January 2008 to August | To continue to monitor and collect accounts receivable in the manner described in the Accounts Receivable Policy. |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | | | | 31, 2009, the City received payments from the supplier averaging $194,000 per month. More specifically and as an example, the City received payments in April 2009 of $421,550, May of 2009 $151,000 and July 2009 of $230,000. The payment history reflects the City's on-going and persistent efforts to collect these amounts.<br><br>The City has best practice collection procedures that are set out in the Accounts Receivable Policy and these procedures were documented in a report to Council dated April 22, 2010. | |
| 8 | Where appropriate, credit limits should be reviewed and established on accounts receivable. | | | The Accounts Receivable Policy states that appropriate credit limits are to be established by the Director of the Operating Department in consultation with Finance. | Continue to adhere to the Accounts Receivable Policy. |
| 9 | Management should consider developing a new policy for determining the amount of the letter of credit. For example, the value of the contract as well as other risks (financial, operational, etc.) should be | | | The City's construction contracts for capital projects have specific guidelines for the amounts that the City is to collect for bid deposits, bid bonds and letters of credit. | Building on the guidelines in place for construction contracts, Purchasing, in consultation with Legal, will develop a policy and procedure that will apply to other types of contracts by the end of |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | considered in establishing an amount for the letter of credit. The policy should consider instances were exceptions are made, how these exceptions are documented and what approvals are necessary. | | | | the first quarter of 2012. |
| 10 | When letters of credit are used, they should be reviewed when contracts are extended and renewed, and changes made as required. Having the ability to review and make changes to the amount of a letter of credit must be included as part of the terms of the contract. If a letter of credit to an acceptable amount cannot be secured, other controls should be put in place to ensure collectability of City funds. | | | It is the City's practice to review letters of credit and certified cheques when contracts are renewed and extended. As noted by the AG in his comment at 9, there are many factors that are considered when establishing the amount of the letter of credit. | Clarification will be provided by the action plan in Item 2 and 9 above. |
| 11 | If the City pursues any further collection attempts on the receivables owing, the City should attempt to collect the full amount of interest payable on the account. | | | Council has been advised by Legal that the City is in the process of conducting examinations of the Company in an effort to determine if there is any possibility of collecting on the court judgement against the Company. | Legal will consider this as it moves forward. |

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | | | | Further comments cannot be provided since they relate to matters where direction was provided by Council in-camera.<br><br>Regarding the potential interest payable, a balanced discussion of this issue is required. There are two positions that could effectively be made. One is that the interest is owed and the other is that the interest is not owed. The AG's position is that the interest is owed. On the other side of the discussion the following should be noted.<br><br>The 1999 contract had interest but the 2004 contract did not have an interest provision and therefore it could be argued that there was an agreement not to charge interest.<br><br>Further, since interest was not billed, the supplier would not have knowledge that interest was owed and consequently it could be argued that no interest applies.<br><br>If the imputed interest argument fails, then the City is left with the Court rates applicable | |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | | | | to litigation which is very conservative. The rate the City was awarded on the judgment against 1211250 Ontario Inc. was 2% per year (compounded annually) which is much lower than the imputed interest rate of 15% per year. The claim of $252,000 in accumulated imputed interest is far from certain and would be challenged. | |
| 12 | In managing contracts, the City should ensure that all of its policies, procedures and by-laws are followed. Contracts should be written to ensure that they comply with the City's policies, procedures and by-laws. Any exceptions should be clearly noted and approved by Council. | | | See item 6 and 11 above. | |
| 13 | Management should ensure that invoices are paid only in accordance with the contract and, more specifically, to the proper legal entity. No manager is authorized to initiate payments to a legal entity (an individual or a company) for services received, when that legal entity, | | | Agreed | This will be incorporated in the policies and procedures being developed in Accounts Payable. |

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | has not provided those services. | | | | |
| 14 | Controls over access to the alternate payee field needs to be reviewed to ensure that there is limited access. Access to the alternate payee field should only be permitted when there are legal documents to support the change, as approved by the City Solicitor. | | | Agreed that controls over the use of the alternate payee field should be in place.<br><br>A determination of what type of documentation and approvals are required will be established through the action plan. | These matters will be incorporated into the Accounts Payable policy work described in Item 13 above. With respect to this matter we will consult with Legal.<br><br>CGS is currently in the process of upgrading the PeopleSoft Financial software to version 9.1 and through the fit gap analysis will be exploring what functionality is available to strengthen internal controls. |
| 15 | An exception report should be developed which management can review that would indicate where the payee on the cheque is different than the name on the vendor master file/contract. | | | See comment in item 14 above. | |
| 16 | When City Solicitor authorized changes are required to the name on the vendor master file to reflect any necessary amendments to | | | See comments at item 14 and further the City has a procedure for the regular deactivation of inactive vendors. | To be incorporated in the action plan item described in 13 and 14 above. |

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | the contract, Accounts Payable should inactivate the existing vendor and set up a new vendor with the proper information. This way, the accuracy of historical information is maintained. | | | | |
| 17 | In order to simplify lease administration and reduce the risk of payment errors, the City should develop a system to flag when lease and contract renewals are coming due.<br><br>Auditor Comments:<br><br>*This solution was identified by management, and the Auditor General agrees that this would improve internal controls. It is a normal internal audit practice to recommend improvements working cooperatively and with the advice of management.* | | | The AG has adopted a recommendation in this updated report that was put forward by management in its response to the original recommendation.<br><br>A system to flag when lease and contract renewals are coming due is required. If there is an effective system in place, then the renewal date should not be an issue. We do not agree that it would be more beneficial to have all leases renewing on January 1 and further it is not common business practice. Renewing leases and contracts can be significant work and having it all occur for January 1 is not practical. | Action plan described in item 2 above. |
| 18 | If any further collection attempts can be made, the City should attempt to recover the missed revenues under the terms of the | | | | Legal will assess the City's abilities to collect these amounts. This is on- |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | contracts. Auditing the financial records of the company would determine the actual amount owing to the City. | | | | going. |
| 19 | As part of the City's due diligence in awarding contracts, business searches should be considered. The City would need to state in the RFP that the City may request that the vendor submit to a business search prior to the award of the contract. A business search should be mandatory for all revenue generating contracts. Due to the cost of performing such a search, for all other contracts, management should decide and document whether to request that the vendor do a business search. | | | Management will undertake a review of the processes, policies and procedures related to contract administration (as noted in 2 above). In addition, this will be reviewed when the updated purchasing by-law is presented to Council. | To be reviewed by Legal and Purchasing in 2012. |
| 20 | The Auditor General's office should be informed when there is a potential substantial financial loss to the City. The Auditor General can work with management to determine the extent of the loss as well as to recommend | | | Agreed | |

Appendix 2

Management Response: 2010 Audit Of Greater Sudbury Transit Services – Transit Kiosk and Café Contract Management

| Rec No | Recommendation | Agree (X) | Disagree (X) | Management Comments: *(Comments are required only for recommendations where there is disagreement.)* | Action Plan/ Time Frame |
|---|---|---|---|---|---|
| | improvements to controls intended to prevent similar losses in the future. | | | | |
| 21 | The CAO should provide direction to staff that would confirm that the Auditor General's office is required by law to be provided with the information it requests in a timely manner. | | | Council has provided this direction. | No action required. |

*Auditors Acknowledgement*

We wish to express our appreciation for the cooperation and assistance provided to the audit team by all staff involved in this process.

# 2010
# Audit of Greater Sudbury Transit Services

## Transit Kiosk and Café Contract Management

By: Brian Bigger, Auditor General
On: October 5, 2011
To: Audit committee

# Auditors Comment

- In order to be effective, the Auditor General's Office is heavily reliant on the continued cooperation of council and management.
- The role of the Auditor General is to encourage people to adopt good practices that are supportive of, or enhance the quality of stewardship over public funds, and the achievement of value for money through operations.
- The main operational function of the Auditor General's Office is to complete audits, recommend improvements often with the advice of management, and to provide those reports to Council.

# Auditors Comment

- The Auditor General assists Council Members by providing information that is intended to support their oversight role in accordance with the Municipal Act (2001)
- Audits, out of necessity, are limited in scope, and often reflect conditions that existed at a certain point in time or over a specific period of time.
- The Auditors have the unique opportunity to compile vast amounts of information related to a specific topic and evaluate that information through hindsight.

# Auditors Comment

- Also out of necessity, the auditor's focus is on what in the auditor's opinion, can and should be improved.
- Observations, findings, and conclusions found in our report should NOT be interpreted to be a comprehensive appraisal of personal performance.
- They should not be used to place blame, for events that have occurred in the past, but instead to identify areas that can be improved in the future.

# Objectives

- The audit was conducted as an extension of the Conventional Transit Audit based on further information revealed through the Transit audit and the Accounts Payable audit.
- The objective of the audit was to evaluate the quality of stewardship over public funds relating to the issuance, renewal and administration of contracts.
- Due to the loss incurred by the City in the operation of the Transit Kiosk, the Auditor General evaluated the risks and controls relating to the management of all three contracts with 1211250 Ontario Inc.

# Audit Methodology

- Our audit included a review of the following topics:
  - Reviewed the contracts for the operation of the Transit Kiosk, the Transit Café and the Airport Café;
  - Reviewed relevant policies, procedures and bylaws;
  - Reviewed transactions and supporting documents such as cancelled cheques, invoices, etc. from 2004 to the termination of the contracts, relating to the payment of the monthly management fee, sale of Transit tickets on consignment and other revenues owed to the City under the terms of all three contracts;
  - Requested and reviewed copies of letters to management and information provided to Council from the external auditors;

# Audit Methodology

- Reviewed various legal documents relating to the closure, collection attempts and court judgment for the outstanding account receivable;
- Conducted interviews with Transit management, Finance management and the City Solicitor;
- Consulted with outside legal counsel;
- Reviewed and discussed findings with management.

# Audit Findings

- Management did not administer the contract according to its terms.
- The contract required that cash from all ticket sales be reconciled by the 25th day of each month and payment for these tickets be made to the City by the 5th day of each month, prior to the delivery of additional tickets.
- However, management repeatedly advanced tickets to the Company without first obtaining payment for the previously advanced tickets.

# Audit Findings

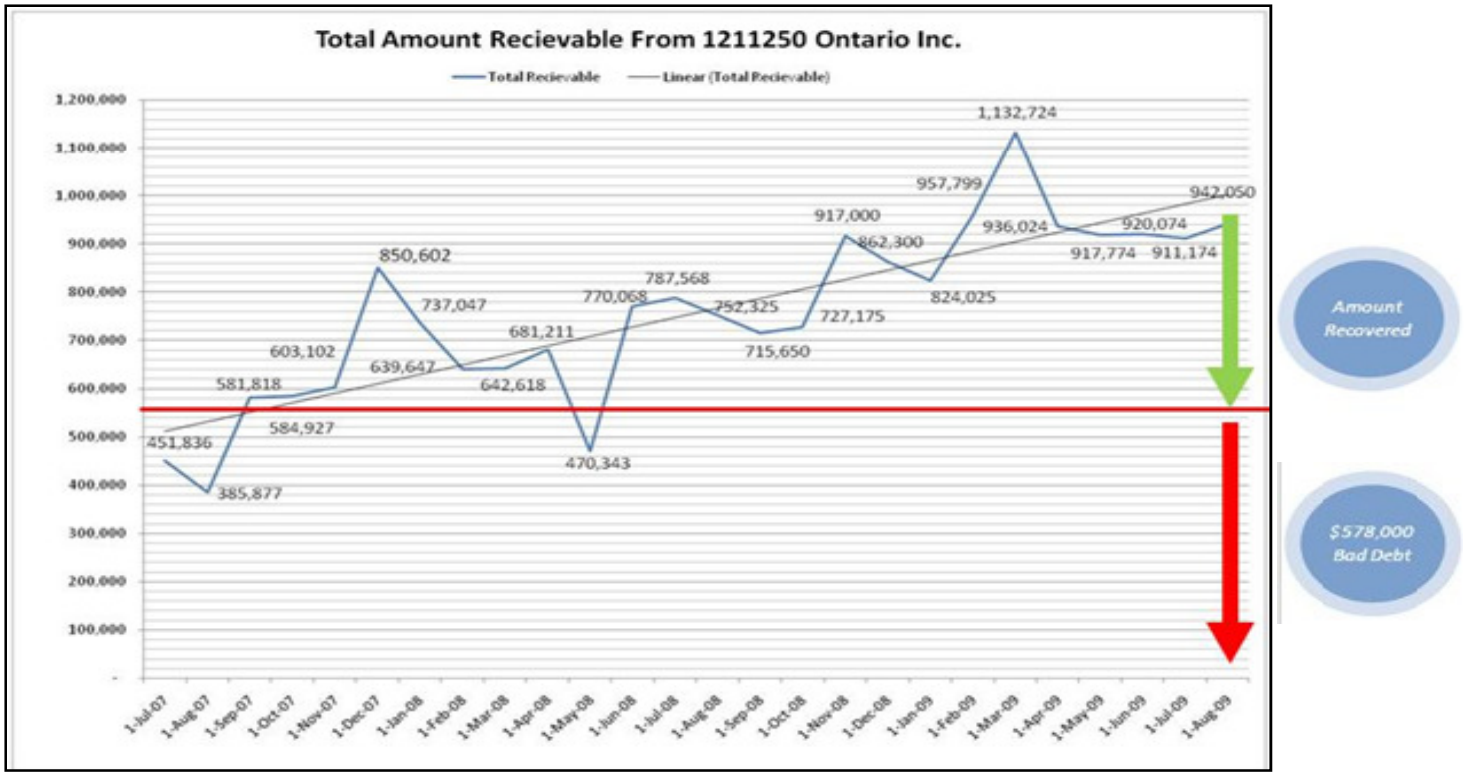
- Although there were other available methods to protect these cash proceeds from significant loss, those methods were not identified and adopted by management.
  - The City's cash could have been directly deposited to the City's bank account by the Company on a daily basis; or
  - The City's cash could have been collected from the Company on a daily basis, and directly deposited to the City's bank account.

# Audit Findings

- A January 2008 report to management stated the following:
  - "While KPMG was in attendance at Transit it became known that one of the vendors was in arrears in excess of $800,000. It was clear that there was no active follow-up on overdue receivables."
- In May 2008, a Request for Decision regarding Transit Administration Staffing was presented to Council. It asked for the authorization to create one permanent full time Cashier position in order to implement new financial control procedures as a result of the control deficiencies identified by KPMG.
- The position was created and filled.

# Outstanding Receivable

- By March 2009, the receivable was at its peak, with the Company owing the City over $1.1 million dollars.



# Audit Findings

- No interest was paid for amounts in arrears under the Transit Kiosk contract.
- No "exception" in not charging interest, was formally approved by the Chief Financial Officer and Treasurer in accordance with the User Fees Bylaw.
- If the 2004 Kiosk contract would have provided for the City to charge interest in accordance with the User fee Bylaws on the overdue amounts between September 2004 and September 2009, the amount owing would have increased by approximately $214,000 of interest.

# Audit Findings

- If the interest rate set out in the User Fee Bylaw can now be charged against that entire balance, applying the interest rate specified in the User Fee Bylaw, would result in an additional interest charge of approximately $252,000.
- Potential interest charges would then have totaled approximately $466,000 as of May 31, 2011.

# Audit Findings

- **Erroneous Payments**
  - Approximately $18,000 was paid to 1211250 Ontario Inc. for tickets returned to the City. The City should have processed a credit invoice against the account receivable rather than issue a cheque.
- **Monthly Management Fees**
  - In 2004, $22,500 of duplicate management fees were paid.
  - Additional overpayments totaled $2,116 for invoices dated between January 2005 and January 2008
- **Property Taxes**
  - For both the Transit Cafe and the Airport Cafe, the City was to bill and collect property taxes. The City did this under the Airport Cafe contract, but not the Transit Cafe contract.
  - Based on the information Audit was able to obtain, Audit estimates that the commercial taxes recoverable from 1211250 from 2004 to 2009 are approximately $17,000.

# Audit Findings

- **Payment of a Percentage of Gross Revenue**
  - Under the terms for both the Transit Cafe and the Airport Cafe lease agreements, the Company was to pay 15% of its gross revenue each month, less the amount payable as minimum rent.
  - Transit management did not request or obtain either monthly or annual statements in order to calculate whether any monies were owed to the City as a percentage of gross revenue.
  - Although annual gross revenue was submitted for the Airport Cafe to the Finance Department, the Company was never billed for these additional revenues. The lost revenue from 2004 to 2009 at the Airport was approximately $8,000.

# Payment Summary

- Between January 2004 and September 2009, the majority of Kiosk Management Fees (70%) were paid personally to this individual

| NAME OF PAYEE | | AMOUNT PAID |
|---|---|---|
| The individual (Company Director) | | $533,506 |
| Zio's Cafe | | $70,438 |
| Zio's Tuck Shop | | $116,848 |
| Zio's Runway Cafe | | $47,172 |
| Falcon Wings | | $10,700 |

# Audit Findings

- No manager is authorized to pay any person, whether an individual or a company, for services invoiced when that person has not provided those services.
- Under the written agreement between the City and the Company 1211250 Ontario Inc., each month the City was obligated to pay the Company a management fee to operate the Transit Kiosk.
- The City and the Company were the only parties to the agreement. Therefore, these Transit Kiosk management fees should have been paid to the numbered Company, and to no one else.

# Audit Findings

- Although the City was attempting to collect monies from the Company and issued a Notice of Default letter on August 31, 2009. The next day (September 1, 2009), Transit issued $22,750 worth of tickets to the Company.

- When the City took over operations on September 4, 2009, the City recovered $96,000 worth of unsold Transit tickets.

# Audit Findings

- Based on information revealed during the course of our audit, the Auditor General's legal counsel advised that :
  - "It is likely that civil fraud or other actionable wrongdoing has occurred" if the Company Director(s) who received the benefit of the management fees, also controlled the disposition of the missing Transit Revenues.
  - Generally Accepted Government Auditing Standards require the Auditors to report their findings when any kind of fraud or misconduct may have occurred.

# Observation

- The Auditors asked City management to explain why, if the Company Director(s) received the financial benefit of the contract personally, they should not also bear the contractual burden of repaying the Taxpayer's money.

- As the contract with the City provided no legal basis for either the Company or any of its Directors to keep the proceeds of the sale of the City's transit tickets for themselves, the Auditor General has been unable to determine any equitable or legal basis for the Company Director(s) to claim that the City's money was theirs to spend.

- The cost to preserve the City's right and ability to recover the money through a civil claim was estimated to be approximately $5,000.

# Observation

- Access to Legal Services files was initially blocked. Council later allowed the Auditor General access to the Solicitor, and City legal files related to this case.

- To date, no clear and compelling explanation has been received as to why the lawsuit against the Company was not expanded to include the Company Director who received the payments personally, or alternatively, why that individual was not sued in a separate lawsuit.

- Ontario's Limitations Act imposes a statutory time limit within which to sue. It is 2 years after the cause of the lawsuit arises. After that date has passed, unless the City could prove that it was unaware that it had the right to sue, the City would likely have no further ability to sue the individual to recover its money.

# Contract Audit Conclusion

This report contains 21 recommendations related to improvements in the management of contracts

- Our recommendations relate to the need to:
  - Improve the quality of contract drafting, management and oversight
  - Improve the controls surrounding payment processing and oversight
  - Improve the due diligence performed by the City in awarding contracts
  - Clarify the application of the User Fee Bylaw related to the recovery of interest on overdue amounts owed the City

Implementing the recommendations contained in this report will strengthen controls. It will also improve management's ability to manage contracts and make necessary changes in order to safeguard public funds.