Office of the City Auditor

2002 Annual Report

March 27, 2003

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Introduction

The Office of the City Auditor (OCA) is pleased to present a summary of its activities during the year 2002. The OCA's continuing development of an operational style that focuses on effective relationships with City Council, the Administration, and the External Auditor and on identification of workable solutions continued to show results. It was not uncommon to observe implementation or initiation of project recommendations even prior to completion of audit fieldwork. The OCA's commitment to value-added recommendations has gone far toward sustaining a healthy relationship with its stakeholders, enabling the OCA to work cooperatively with its clients to derive effective solutions to observed operational challenges. During 2002, all audit recommendations were accepted or accepted with modification and implemented or scheduled for implementation by the Administration.

The OCA's effectiveness has again been confirmed by increasing numbers of requests from Council and the Administration for assistance with operational analysis and identification of cost-effective operational and system controls, operational policies and directives, and design and delivery of corporate training initiatives.

Observations

Program and Service Review

In the opinion of the OCA, the City needs to evaluate programs and service levels if substantial reductions in tax levy demands are to be accomplished in future budgets. Without those reductions, the long-term sustainability of existing budget practices is suspect. Reductions in tax levy demands in any given year can be accomplished in six basic ways: enhancement of revenues, reductions in operating costs, delays in program funding, increased budget accuracy, reductions in service levels, and elimination of programs. Enhancement of revenues shifts the funding burden to the users of the services rather than drawing from tax revenues. Significant reductions in operating costs usually require substantial efficiency gains. Delays in program funding can reduce short-term expenditures, but in most instances only postpone expenses, in some cases to the overall detriment of the program (e.g., delayed maintenance of a building). Increased budget accuracy can result in reduced demands for tax-levy funding with no impact on service levels. Reductions in service levels and elimination of programs reduce budget demands by reducing services to citizens. Increased budget accuracy and operational efficiency gains would likely be the most desirable of these options to the citizens.

Incremental cost savings opportunities are often identified during the OCA's operational audits of business units. Based on the OCA's observations, significant corporate savings from easily achieved operational gains appear to be unlikely. Substantial reductions in draws against tax levy will only be achieved through cost savings that are based on a more fundamental review. The significant downturn in the bond and equity markets over the past two years has added to the momentum toward implementing a more fundamental review. With the City's investment income dropping below zero (on paper), dividend income can not be relied upon in the short term. In addition, deregulation (with the resulting market competition), technology demands, and potential provincial legislation may influence dividends from a historically stable provider (EPCOR).

The OCA believes that targeted review of specific programs and service levels should be conducted as a part of the budget process each year. The Administration is currently considering a variety of options, including service changes, to achieve cost savings for the 2004 Budget. The OCA intends to include program cost-benefit evaluations in its operational review projects as a complement to any efforts undertaken by the Administration.

Audit Committee Enhancements

The City's formal audit structure was strengthened during 2002 with City Council's creation of the Audit Committee as a standing committee of Council. The Audit Committee holds scheduled meetings each quarter to review the internal and external auditors' work and to request clarification of matters as appropriate from management. The OCA believes that this new structure will enhance Council's ability to provide appropriate oversight of audit and management functions. The Terms of Reference document is designed to ensure that members of Audit Committee receive ongoing training and awareness related to audit issues and that the City Auditor provides assistance to the Committee as it performs its financial governance role. It also provides clarification of roles and responsibilities of all stakeholders (City Council, Audit Committee, City Auditor, External Auditor, and City Manager). The Terms of Reference and supporting changes to applicable bylaws are designed to reflect adaptations of recent developments in corporate governance best practices in the private sector to a municipal environment.

Ongoing Initiatives

Policy Development and Assistance

The OCA continues to be involved in a consultative role with the Administration by providing control, process, and governance input during policy development. During 2002, the OCA was involved in development of the City's Code of Conduct, cash-handling policies for both EPS and the City, and the City's FOIP processes.

The OCA also continued its involvement in providing assistance to the Administration in a variety of corporate and departmental projects and steering committees including:

- Corporate business planning and budget process review (continuing into 2003),
- Maintenance management system development (MAIN-LINK – continuing into 2003),
- ERD's Quality Assurance and Improvement program,
- FOIP Steering Committee,
- Redesign of the process for procurement of professional services, and
- Managing end-user computing.

The OCA also serves as a best practice research resource for the corporation.

Corporate Training

The OCA continued to participate with the Administration in development and delivery of corporate training initiatives in the areas of economic crime awareness and project management training for City staff. The Economic Crime Awareness course plays an important role in increasing City staff's sensitivity to indicators of fraud and other forms of economic crime. One indication of the success of this initiative has been the increase in numbers of fraudulent activities that have been detected since this program was implemented in 1999. As of the end of 2002, 332 employees have participated in the Economic Crime Awareness course in 23 workshops.

The OCA's involvement in helping develop and deliver the City's project management course has been well received and several managers have expressed their appreciation to the OCA. As of the end of 2002, 387 have participated in the Project Management Overview course in 12 workshops.

Corporate Business Risk Planning

During the review of the Office of the Auditor General (now the OCA) in 2000, City Council approved in principle the implementation of an Enterprise Risk Management (ERM) program for the City. At the time, ERM was quite advanced in the financial and insurance industries, but little work had been done to successfully implement it in the public sector. Those programs required substantial modification to work effectively in a public sector environment.

Corporate Business Risk Planning (CBRP) is the City of Edmonton's adaptation of Enterprise-wide Risk Management—a tool used in a variety of industries to ensure that all forms of risks to an organization are managed appropriately. The OCA has teamed with the Administration to co-lead this project. A project team of representatives from each department and applicable corporate disciplines has been formed to develop a system for risk planning that will be integrated into the existing business planning and budgeting processes to ensure that enterprise-wide risks receive appropriate

consideration during the City's planning processes. Basic process design was largely complete by year-end 2002 and the draft model will be introduced early in 2003.

Financial Governance

The OCA began to provide financial governance review services near the end of 2002 as a part of its new responsibilities assigned with the creation of Audit Committee. These services are designed to provide Audit Committee with independent reviews of financial matters and, thus, assist committee members in their oversight role.

Completed Projects

Quarterly Report Issues and Observations

During 2002, the OCA issued four Quarterly Reports that identified general awareness matters or issues that were identified during each reporting period and concise summaries of reports that had been released during each reporting period. Issues and observations as well as responses to Council's motions discussed in 2002 included:

- **Succession Planning:** As is the case for many corporations in North America, the issue of succession planning is reaching critical awareness within the City of Edmonton.
- **Value Analysis:** The development and approval of a general corporate policy for cost/benefit analysis and risk assessment will assist in achieving the goal of ensuring value for money.
- **Digital Print Centre:** Based on the financial analysis of the draw on tax levy, there has been an opportunity cost to the City in running its own Digital Print Centre under the Public/Private Partnership form of contract. Most of the expected outcomes of the partnership have not been achieved. The Administration is in the process of initiating a Corporate Printing Strategy and assessing alternative service delivery options for the City's overall printing requirements, including service provided by the Digital Print Centre.
- **Audit Committee:** The OCA recommended that the Procedures and Committees Bylaw 12300 be amended to establish a separate standing committee called the "Audit Committee." Those amendments and supporting amendments to the City Auditor Bylaw 12424 were approved by City Council.
- **Financial Governance:** The newly approved Terms of Reference for the City's Audit Committee define a new role for the City Auditor in conducting financial governance reviews on behalf of Audit Committee.

Identified Cost Savings

The OCA produced 22 audit reports during 2002. All City departments were affected by recommendations that dealt with issues of efficiency, effectiveness and economy. While not the overriding goal of the OCA, identification of annual cost savings during our

audits is significant. Specifically, the OCA in conjunction with the Administration identified potentials for direct cost savings, revenue gains, and expense reimbursement in the following areas:

- **Business Licensing:** The analysis conducted during the Business Licensing Revenue Opportunities Review indicated that revenue from business licensing fees was not being maximized. The potential for significant additional annual revenue (up to $950,000) that could be collected through license fees, non-resident vendor surcharges, and late payment penalties was identified and presented to Planning and Development for validation and appropriate implementation.

- **Water Contracting:** The OCA's investigation into the questionable conduct of a water contractor responsible for watering and fertilizing the City's newly planted trees revealed that the water contractor significantly over-stated the number of hours worked and trees watered per day. Given the results of the investigation, admissions by the contractor, and advice received from the Law Branch, Mobile Equipment Services cancelled the water contractor's contract and payment of the final billing of $3,900. The water contractor also agreed to pay $15,000 as reimbursement for over-billings and signed a promissory note.

- **Valley Zoo:** The OCA conducted an investigation into potential misappropriation of funds by a former City employee at the Valley Zoo. The OCA's analysis of the transactions performed by the subject indicated that total losses to the City amounted to $19,300 over a three-year seasonal employment period. In February 2002, the City filed a successful insurance claim for reimbursement of the losses suffered as a result of the misappropriation of funds.

- **Parkade Operations:** The OCA conducted an investigation into parkade operations after Asset Management and Public Work representatives reported a suspicion of theft. The investigation revealed that fraudulent activity had occurred. On May 1, 2002, the ex-employee appeared in court and received a suspended sentence, eighteen months of probation, 100 hours of community service, and an order to repay the City $680.00.

- **Bus Pass Theft:** A joint investigation by ETS Security & Risk Management, Corporate Security, and the OCA was conducted into the theft of an unknown number of student bus passes during the production process. At the conclusion of this investigation, a criminal charge of theft under $5,000 was laid by EPS against an employee of one of the vendor's subcontractors. The OCA also recommended that the matter be reviewed by the Law Branch to determine what rights the city has to bring an action for a potential recovery from the vendor or other parties for the $15,723.38 spent to reprint a portion of the student passes.

- **Expenditure and Revenue Review:** The OCA coordinated the Expenditure and Revenue Review Project for the 2002 and 2003 budget years. During the 2003 Expenditure and Revenue Review Project, the Administration achieved $10.8 million in reduced draws against tax levy. This exceeded the corporate target by $0.8 million. In addition, a $1.1 million one-time unsustainable revenue increase (related to permit revenues) was identified.

Value-added Recommendations

In addition to the tangible cost savings identified above, many of the OCA's recommendations in 2002 will add value to the corporation, either through improved effectiveness, better customer service, or indirect cost saving. For example:

- **Out-of-School Care:** Payments to operators in the Out-of-School Program will be controlled more effectively in the future as a result of the Out of School Care Process Review. The Community Services Department accepted all the recommendations in this review and initiated the process of redesigning the control systems to reduce the risk that OSC centre operators or parents/guardians may overstate hours of care.

- **Cellular Telephones:** Recommendations contained in the "Review of the City's Telecommunications – Cellular Telephones" will improve controls over the acquisition and use of cellular telephones.

- **Economic Development Edmonton:** Recommendations made in the "Economic Development Edmonton Follow-up Review" will lead to improved financial policies and procedures, providing assurance that EDE's financial practices are consistent, accountable, and economically justified.

- **Drainage Operations:** The Drainage Branch requested the OCA's assistance in implementing the recommendations made by the OCA in its operational audit of Drainage Operations Section. As a result of our review and assistance, the Drainage Branch has implemented new work methods for low pressure flushing and developed associated productivity standards. The initial productivity increase for low pressure flushing has been calculated to be 20% greater than its historical baseline level.

- **Travel and Training:** Recommendations contained in the "Travel and Training Review" will establish greater accountability on the part of management to record, monitor and evaluate training needs.

- **Assessment:** Recommendations contained in the "Assessment Review" complemented the organizational design and re-engineered work processes that were underway within the Assessment & Taxation Branch. Overall, it was found that the new organizational design and re-engineered work processes were consistent with best practices. Seven opportunities for improvement were identified to further enhance existing processes and are expected to achieve a further reduction in numbers and values of successful tax assessment appeals.

- **Payroll and Benefits:** As part of our review of Payroll and Benefits Service Provision, we determined and compared the costs and benefits of providing payroll and benefit services internally versus externally. It was concluded that based solely on a financial analysis of internal and external service provision, it is unlikely that contracting for payroll and benefits services would be cost effective at this time.

- **Cash Handling:** Cash Handling Reviews determine whether cash resources are handled in a manner consistent with established City requirements and to assess the adequacy and effectiveness of internal controls at each location. These reviews consist of an objective review and evaluation of the cash handling practices

(including credit cards, debit cards and cheques) and procedures relating to receiving, transporting, storing, depositing, recording and safeguarding City money. In all cash reviews conducted by the OCA, the OCA's goal is to assist the Administration with strengthening internal controls and improving methods of prevention and early detection of fraud. In 2002, Cash Handling Reviews were completed at the following locations: Muttart Conservatory, Fort Edmonton Park, Municipal Cemeteries, Valley Zoo, and Transportation and Streets – Parking Meters. The OCA also provided assistance in reviewing the steps undertaken by the Administration to minimize the risk of loss to the City when employees of the vendor providing transportation of City money were on strike.

- **SAP User Access and Security:** In April 2001, the City upgraded to SAP version 4.6. The OCA ensured that the Audit Information System contained in this version was fully operational. The review also focussed on ensuring that user access to the system is authorized and that security levels are consistent with proper segregation of duties and privacy legislation. Opportunities for improvement contained in this review will enhance the City's security environment.

Ethics Investigations

During 2002, the OCA provided advice and conducted investigations related to the following types of ethics issues:

- Contractor/employee status of employment (three)
- Misuse of email (one)
- Internet usage monitoring (one)
- Conflict of interest (three)

Due to the sensitive and confidential nature of ethics advice and investigations, detailed reports on these matters are not routinely issued by the OCA.

2003 Annual Work Plan

The 2003 Annual Work Plan focused on those areas of highest risk in the corporation and balanced demands for projects between the traditional guardian role and the agent of change role. Over 67% of the projects considered during planning for 2003 (65% in 2002) originated from Administration requests for the OCA's assistance. This demonstrates the Administration's recognition of the OCA's commitment to add value to the Corporation and their increasing awareness of the skills available within the OCA. The criteria used for evaluating potential projects included:

- Volume and value (assets, expenditures, or transactions)
- Vulnerability (cash, ease of conversion to cash, sensitivity of information)
- Regulations affecting the operational area
- Management control environment

- Sensitivity (visibility/degree of public interest)
- Audit or review history of the area
- Overriding considerations (degree of impact on operations, Council direction, carry-forward projects, etc.)

The 2003 Annual Work Plan includes 19 projects, of which four are general categories that will result in multiple reports (investigations, emerging issues, systems development, and follow-up reviews).

The OCA intends to work toward refinement of the processes used to develop the OCA's Annual Work Plan and long term audit plan. One of the refinements will be to establish a connection between the OCA's plans and the outcomes from the Corporate Business Risk Planning process (this process is under development in 2003).

Performance

The table on page 9 presents a summary of the OCA's performance for 2002. The OCA has chosen customer relationships, internal measures, training, and budget performance as the most significant indicators of overall performance. Those measures are presented for the past four years to allow trend analysis.

The OCA is committed to continuous improvement. One means of accomplishing continuous improvement is to periodically participate in a peer review of our audit processes (planned for 2005). The OCA plans to send a representative to the peer review workshop held at the National Association of Local Government Auditors conference in Toronto in June 2003. The workshop will provide further guidance in preparation for the 2005 peer review.

The OCA continues to promote involvement of its staff in professional development activities with their professional associations and other organizations. In 2003, some of those activities included attendance and participation in fraud investigation, project management, auditing, ethics, engineering, and accounting conferences, courses, and seminars. In the table on page 9, the Learning category includes not just formal training, but also attendance at and participation in other professional development activities.

Conclusion

The OCA continued to make significant productivity and relationship gains during 2002 as a result of the redesign of its fundamental methodology and philosophy regarding scoping, performance, and reporting of audit projects in 2001. The OCA's greatest effectiveness comes from those areas in which it can contribute toward process improvement in response to medium to high operational and strategic risks. Focussing on areas of highest risk has helped to ensure that productivity gains are enhanced and that the OCA continues to provide value-added services to the corporation.

Performance Trends

Performance Indicator	Target	1999	2000	2001	2002
Customer Relationships	**(1 - 5)**				
Communication How well the client was informed of objectives, process, timeframe, and emerging findings.	**4.5**	4.4	4.4	4.4	**4.8**
Understanding of client's business How well the audit staff demonstrated their understanding of the issues and challenges faced by the client.	**4.5**	3.9	4.0	4.3	**4.7**
Professionalism How well the audit staff demonstrated professional behaviours and attitudes in their dealings with clients.	**4.5**	4.4	4.4	4.7	**4.8**
Quality of findings How practical and thorough the audit findings were and how openly the audit staff communicated with the clients	**4.5**	4.0	4.3	4.3	**4.7**
Overall average Overall judgement by the client of the value received.	**4.5**	4.2	4.3	4.5	**4.7**
Internal Measures	**(% or #)**				
% Recommendations accepted Best audit practices will result in the majority of recommendations being accepted by the client.	**90%**	82%	76%	86%	**95%**
% Recommendations accepted with modification Some recommendations may require minor adjustments to be operationally practical.	**10%**	9%	24%	14%	**5%**
% Recommendations rejected Best audit practices should result in relatively few recommendations being rejected.	**0%**	9%	0%	0%	**0%**
% Administration & training hours vs. available time Administration activities include strategic planning, training, library time, office meetings, informal consultation with clients, maintenance of the OCA web site and time accounting system, etc.	**20%**	18%	23%	16%	**28%**
% Chargeable time vs. available time[1] A measure of the available time worked on projects.	**80%**	82%	77%	84%	**72%**
Projects completed per auditor This is a measure of office productivity.	**2.5**	1.1	1.5	2.6	**3.6**
Learning	**(days)**				
Days of City-funded training & development/employee[2]	**8.0**	8.4	7.8	7.4	**8.0**
Financial	**(%)**				
% Actual vs. budget amounts The primary reason for the budget variance in 2002 was the delay of a project that was to have required significant consulting expertise.	**90% to 110%**	95%	89%	81%	**87.1%**

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[1] This percentage was reduced from normal levels in 2002 because of time required to set up the OCA website, reworking the OCA time accounting system, and implementing a new approach for the 2003 annual plan.

[2] This category includes not only attendance at professional development courses but also attendance at and participation in other professional development activities offered by professional associations (IIA, CMA, APEGGA, ISACA, CICA, etc.). During 2002, OCA staff members were also involved in delivering courses and seminars in a variety of settings including courses for City staff, internationally-recognized auditing courses delivered in the US and Canada, and local seminars to audit and fraud professionals.