

AUDIT COMMITTEE - JUNE, 20, 2006

INTERNAL AUDIT REPORT OF WATER, WASTEWATER AND DRAINAGE

Recommendation

The City Auditor recommends:

That the Internal Audit Report of Water, Wastewater and Drainage completed in March 2006, be received.

Economic Impact

In the Internal Audit Report, some recommendations have positive monetary benefits to the City. Other recommendations have intangible benefits as they improve internal controls, risk management and corporate governance. Operational effectiveness and efficiency will also be improved.

Purpose

To present to the Audit Committee the Internal Audit Report of Water, Wastewater and Drainage.

Background - Analysis and Options

The audit was part of the Internal Audit Plan for 2005.

The internal audit report is provided as Attachment 1 and Attachment 2 (Strictly Confidential). The report explains the definition and objective of auditing as well as the scope of audit work. The report includes the observations of the auditor, the implications, the auditor's recommendations, the commissioner's responses for corrective actions and the auditor's response to the corrective actions.

Relationship to Vaughan Vision 2007

This report is consistent with the priorities previously set by Council and the necessary resources have been allocated and approved.

Conclusion

1. The commissioner and director of the department/operation audited, have responded favourably to all findings and recommendations in the Internal Audit Report.
2. When all corrective actions have been implemented, internal controls will be improved, the quality of performance in carrying out assigned responsibilities will be enhanced, the department will operate more effectively and efficiently and the Internal Audit department will have added value to the organization and assisted members of the organization in the effective discharge of their responsibilities.

Attachments

- Attachment 1 – Internal Audit of Water, Wastewater and Drainage
- Attachment 2 – Internal Audit of Water, Wastewater and Drainage (Strictly Confidential)

Report prepared by:

Michael Tupchong, CA, CIA, CPA, CFE
City Auditor

Respectfully submitted,

Michael Tupchong, CA, CIA, CPA, CFE
City Auditor



The City Above Toronto

The City of Vaughan
2141 Major Mackenzie Drive
Vaughan, Ontario
Canada L6A 1T1
Tel [905] 832-2281

Attachment 1

May 13, 2006

Michael DeAngelis
City Manager
City Of Vaughan
2141 Major Mackenzie Drive
Vaughan, Ontario
Canada L6A 1T1

Dear Michael DeAngelis,

Re: Internal Audit of Water, Wastewater and Drainage

I have completed the internal audit of Water, Wastewater and Drainage as of December 13, 2005. This audit was conducted in accordance with the 2005 Audit plan.

A follow-up letter will be sent to the audited department/operation, 30 days from the date of this Internal Audit Report, requesting the status of corrective actions on deficiency items noted in this report. Subsequent follow-up letters may be sent until all corrective actions have been satisfactorily implemented.

I would like to thank commissioner Bill Robinson, director Brian Anthony, and their staff for accommodating me and providing me with unrestricted access to all staff and information during my audit.

I have exercised independence, objectivity and due professional care in accordance with the Standards for the Professional Practice of Auditing.

The Internal Audit Department is committed to adding value, providing continuous improvement recommendations, and providing professional service to the whole organization.

Sincerely,

Michael Tupchong CA, CIA, CPA, CFE
City Auditor

cc: B. Robinson C. Harris B. Anthony R. Meek



We recycle.

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WATER, WASTEWATER AND DRAINAGE

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DEFINITION, OBJECTIVE AND SCOPE

1. Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
2. The **objective** of Internal Auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, Auditing furnishes them with analyses, recommendations, counsel, and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost. In the end, Audit is focussed on continuous improvement of the organization.
3. The **scope** of Internal Auditing encompasses the examination and evaluation of the adequacy and effectiveness of the organization's system of control and the quality of performance in carrying out assigned responsibilities. The Internal Auditors are concerned with any phase of City activity. The scope of Internal Auditing includes:
 - Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
 - Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations, which could have a significant impact on operations and reports, and should determine whether the organization is in compliance.
 - Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
 - Appraising the economy and efficiency with which resources are employed.
 - Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
 - Reviewing the identification of risk exposures and the use of effective strategies to control them.
 - Reviewing specific operations at the request of the Audit Committee or City Manager, as appropriate.

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DEFICIENCY RATING

1. To assist readers in the interpretation of Internal Audit's opinion of the gravity of the reported deficiencies, we have categorized our findings into 5 groups:-

High (5*); Medium High (4*); Medium(3*); Medium Low(2*); Low(1*).

2. In **summary**, there are 0 (5*), 0 (4*), 2 (3*), 3 (2*), 0 (1*) reported in this Internal Audit Report.
3. At the discretion of the commissioner and director(s), this report may be distributed to the appropriate staff members under their jurisdiction. Deficient items which could be common across the organization should be globally addressed. Further consideration should be given to revise/update current policies and procedures, as deemed necessary.

End of Field Work: January 13, 2006

Auditor(s): Michael Tupchong.....

Approved:

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\$10,000 price reduction (3*)

Observation:

1. It was observed that an industrial client required storm water connection, wastewater connection, sprinkler service and domestic water service. The total cost including the 15% by-law charge and 3% service cost was \$84,130.46. The calculation was based on the department's standard calculation for all clients and was appropriately calculated.
2. The client made a big issue of the cost. This resulted in the price reduction of \$10,000 to \$74,130.46. The City's cost was \$71,297. This resulted in a margin of approximately 4% to the City. The department new staff member, was at the time unaware of the City by-law number 286-2004 which calls for Service Connections to be charged at Cost + 15% and therefore deducted these costs from the calculation. The employee is now aware of the by-law and is upholding it.

Implications

1. By-law 286-2004 was not always followed as the employee was in a new position.
2. The department was pressured to reduce costs and departed from its standard calculation.

Recommendations:

1. The department should adhere to its standard price calculation for all customers. Giving discounts would set a precedent.
2. The by-law to charge Cost + 15% should be followed at all times so that there is no contravention of the City by-law.

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Corrective Actions (Commissioner Bill Robinson's Response)

- As has been noted by the Auditor, the employee is now aware of the by-law, no reductions have taken place since this time, and therefore, no further action is required.

Auditor's Response to Corrective Action:

The corrective action response is acceptable to the auditor.

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Service Application Fee Calculation (Storm water, Wastewater and Water Connection) (3*)

Observation

1. On a review of Service Application fee calculations, it was observed that the department charged a Service Charge of 3% to cover the GST. This was valid when the City did recover only 4% back on GST paid and thereby incurred a 3% cost before January 1, 2005. Since January 2005, the City now recovers the full 7% GST back.
2. For service connections, the charge is "at cost" plus 15%. However, for some services, there are no charges to "cover" administration, inflation, incidental and contingency costs. These services are :-
 - Water Turn Off
 - Water Turn On
 - Wastewater and Water Service Call Out
 - Sewer Camera Service
 - Sewer Back-up

For these services, only the hourly rate is charged.

Implication:

1. The City may not be charging enough to cover administration, inflation, incidental and contingency costs when the 15% by-law charge has not been added on.
2. The 3% charge for GST is no longer applicable since January 1, 2005 as the City now recovers 100% of GST paid.

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Recommendation:

1. It is recommended that the department should cease charging the 3% Service Charge for the recoupment of the GST as the City now recovers the full 7% back since 1 January, 2005.
2. The department should however include a 5% charge over its cost. This represents 2% more than the 3% service charge, to cover administration, inflation, incidental and contingency costs where the 15% by-law charge is not added on. If the 15% by-law charge has been added on, then the 5% charge would not be required.

Corrective Actions (Commissioner Bill Robinson's Response)

- The overhead fee is being calculated in accordance with the by-law.
- The current rates for services not already covered by the 15% administration fee were set as a means to recover the average cost to perform such work. For some services, a minimum of 3 hours is charged, even if the work itself only takes 2 hours. Should the Audit Committee concur with the Auditor's recommendation to charge an additional 5% above the fees already established in the Water by-law, staff will include this increase in the public notice when the water rates are next being set.

Auditor's Response to Corrective Action:

The Audit Committee's decision will be accepted.

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Purchase Order Overridden (2*)

Observation(s)

On a review of CWS invoices billed to the City, 3 were observed to include PST which should have been exempt as per the Purchase Order. On checking the posting in the General Ledger account, only one was posted incorrectly ..I.E., the PST was posted as a result of the Purchase Order being overridden.

<u>Invoice #</u>	<u>Invoice Date</u>	<u>Invoice Amount</u>	<u>PST charged</u>	<u>Posted incorrectly</u>
930409	18 Jul 2005	1374.45	109.96	No
000913	21 June 2005	1727.88	138.23	Yes
930554	10 Mar 2005	1178.10	94.25	No

Implication(s)

1. The City is being billed incorrectly for PST which should be exempt.
2. The Purchase Order information was overridden by the Clerk inputting the information.

Recommendation(s)

1. The contractor should be informed to not charge PST on exempt items.
2. The Purchase Order information should not be overridden by the Accounts Payable Clerk without the approval of a supervisor.
3. The error should be rectified.

Corrective Action(s) (Commissioner Bill Robinson's Response)

This error has been rectified by the Budget Co-ordinator at Public Works. She has also informed the Manager of Accounting in the Finance Department of the Purchase Order override by a clerk in Finance. The contractor has been informed not to charge PST as the service is exempt from PST.

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Auditor's Response to Corrective Action(s)

The recommendations have been addressed satisfactorily.

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Wrong Tax Code Used (2*)

Observations

On a test review of vendors' invoices, and checking the posting to the general ledger accounts, it was observed that a few errors were found. The tax code ON01 was used in error instead of code ON05. Tax code ON01 assumes that PST was included in the invoice total. Tax code ON05 assumes that PST was not included in the invoice total as the expense is PST exempt.

1. This occurred for vendors A.Donofrio (March and August) and Triple A Industries Inc(August). The impact was \$991 overstatement of expenses and an understatement of GST.
2. During the audit, this was drawn to the attention of the responsible employee. She has since rectified the situation.

Implications:

The implication of using the wrong tax code means that the amount posted to the expense portion would be overstated and the amount posted to the GST account would be understated. The impact was \$991.

Recommendations:

It is recommended that the incorrect entries should be reversed and that the correct tax code ON05 should be used for the new entry.

Corrective Actions (Commissioner Bill Robinson's Response)

The Budget Co-ordinator has rectified the problem.

Auditor's Response to Corrective Action:

The recommendation has been performed satisfactorily.

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Extension of Contract(2*)

Observations:

1. The contract with Triple A Industrial Service Inc has an Evaluation of Performance clause "Upon completion of the contract, the Owner may complete an evaluation of the Contractor's Performance".
2. The contract expired on 8 March 2005. There was an option to renew the contract for 2 additional 1 year periods. "This option may be exercised only if the Contractor has performed its work to the owner's satisfaction during the previous year".
3. The auditor did not observe written documentation to the contractor, signed by the director, to state that the contract would be renewed for 2 extra years. There was also no evaluation of Performance on file.

Implications:

The existing contract is renewed without an evaluation of the contractor in writing or confirmation of the extension in writing to the contractor.

Recommendations:

1. Before an existing contract is renewed(based on an optimal extension period), it is recommended that a formal written Evaluation of Performance be prepared. It should also be signed off by the appropriate Supervisor, Manager and Director.
2. There should be written correspondence to the contractor, signed by the director, informing him of the decision to exercise the optional extension period.

Corrective Actions (Commissioner Bill Robinson's Response)

- The decision to exercise the optional extension period, as contained in the contract with Triple A, was based on verbal discussions between the Supervisor and the Manager. The quality of work performed had been acceptable, and there had not been any incidents over the term of the contract that suggested exercising the extension periods would not be in the City's best interests. In such cases,

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Public Works would notify the Purchasing Services Department that they would like to exercise the optional time period, who in turn, sends out the necessary letters to the contractor informing them of the decision to extend the contract, and request them to provide any updated insurance, WSIB, or other forms as necessary.

- Notwithstanding, the contract says “may” complete an evaluation., Public Works staff agree that a formal written evaluation should take place prior to any contract being extended, and that the evaluation be signed off by the Supervisor, Manager and Director. A copy of this evaluation will be sent to the Purchasing Services Department so that Purchasing Staff can formally notify the contractor of the extension period, and at the same time, request updates of any necessary documentation such as insurance policies etc.

Auditor’s Response to Corrective Action:

The corrective action response is acceptable to the auditor.

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Conclusion

1. The commissioner and director have responded favourably to all findings and recommendations in the Internal Audit Report.
2. When all corrective actions/recommendations are implemented, internal controls will be improved, the quality of performance in carrying out assigned responsibilities will be enhanced, the department will operate more effectively and efficiently and the Internal Audit department will have added value to the organization and assisted members of the organization in the effective discharge of their responsibilities.