

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

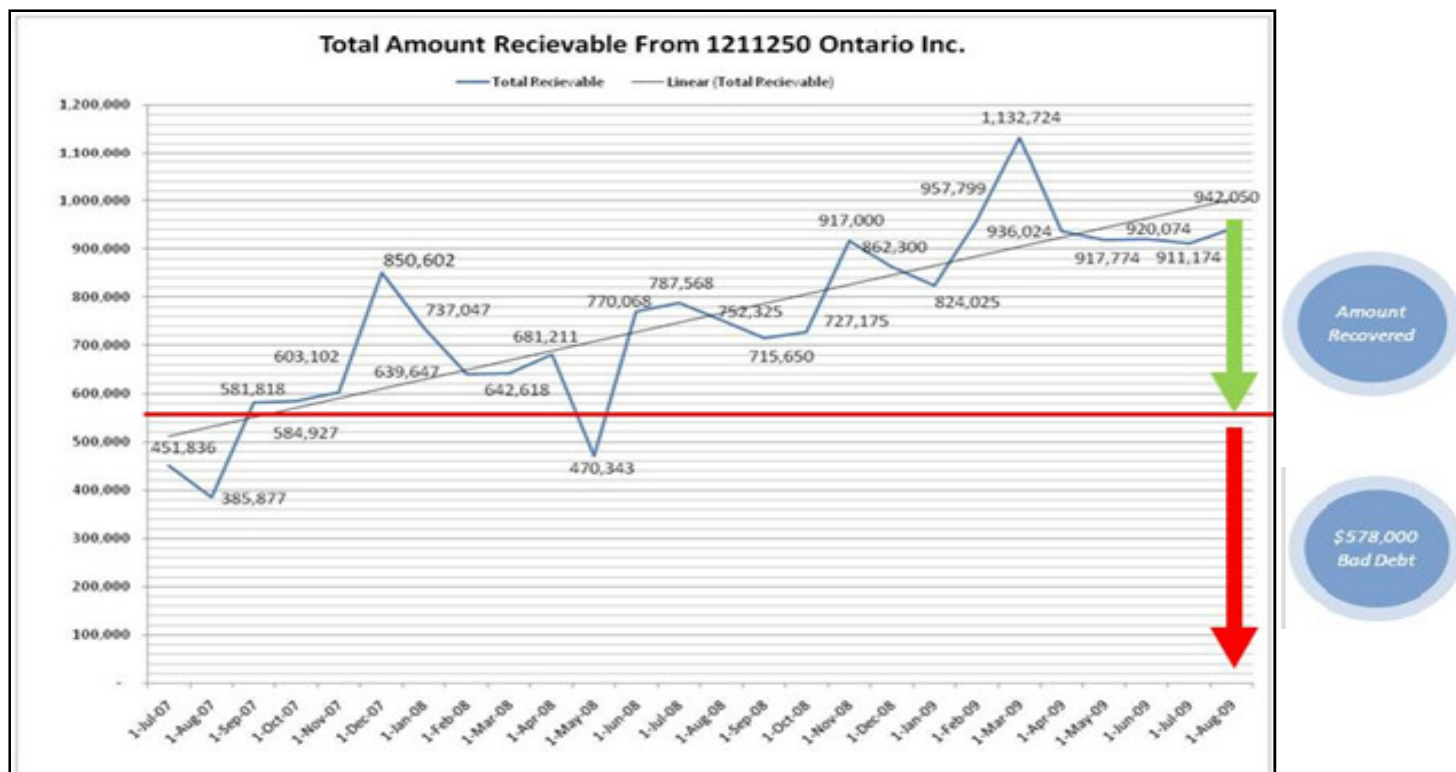
- Although there were other available methods to protect these cash proceeds from significant loss, those methods were not identified and adopted by management.
 - The City's cash could have been directly deposited to the City's bank account by the Company on a daily basis; or
 - The City's cash could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