

**CITY OF HAMILTON
OFFICE OF THE CITY AUDITOR (OCA)
CHILDREN'S SERVICES OCA CONSULTING REPORT**

The leadership in the Children's Services and Neighbourhood Development Division requested the Office of the City Auditor (OCA) to assist in the development of an audit guide and checklist template for their staff to conduct audits of child care operators that receive grants from the City of Hamilton. The following areas were in scope for this consulting engagement:

- The General Operating Grant (GOG) for wages, to ensure that child care operators have used the grant for the intended purpose which is to increase staff salaries and benefits and it meets the City guidelines.
- Verification that the Wage Enhancement Grant (WEG) is distributed as per Provincial guidelines.
- Process to ensure the attendance reports submitted by the Operators for fee subsidies can be verified.

Also included in the scope of this consulting engagement was a commitment to review the current mid-year and annual reconciliation procedure to ensure the reconciliation is adequately performed. Upon finalization and acceptance of the audit guide and checklist by Divisional Management, the OCA participated in 5 operator assessments to ensure effectiveness of the audit program and to train Children's Services staff. The operators were selected by Division Management based on their risk assessment.

BACKGROUND

Funding opportunities are available to child care operators who have a funding agreement with the City. The purpose of available funding is to provide stability to child care programs and support staff retention.

General Operating Grant (GOG)

GOG is part of the core service delivery funding from the Ministry of Education (MEDU) and consists of two components: funding for wages and funding for system priorities.

Wage Enhancement Grant (WEG)

The purpose of this funding is to:

1. Close the wage gap between Registered Early Childhood Educators (RECE) working in the publicly funded education system and those in the licensed child care sector.
2. Help stabilize child care operators by supporting their ability to retain RECEs and non-RECE program staff.
3. Reduce poverty by supporting greater employment and income security.

EXECUTIVE SUMMARY OF RESULTS

Based on the results of the five operator assessments, it was noted that \$48,000 of GOG distributed to child care operators could not be validated or reconciled to employee paystubs. This is 5% of the total approved GOG for these locations. For WEG, the Provincial guidelines had more rigidly defined guidelines, resulting in fewer discrepancies noted in reconciliations reviewed. We noted one instance where the hours were incorrectly calculated resulting in overpayment to the operator of WEG by \$1,100.

We noted cases of inequitable GOG distribution, unreported conflicts of interest and insufficient segregation of duties. We also noted multiple instances where operators were incorrectly reporting child absences (child was absent but marked as present on operators record) resulting in potential inaccuracies in fee subsidy calculations.

The primary reason for this could be attributed to inadequate oversight of the mid-year and year-end reconciliation process and no process to review the related documents. The enhanced flexibility for GOG distribution allowed operators to allocate GOG funding in ways not intended by City guidelines. Additional Management review and oversight is needed to ensure anomalies and required repayments/recoveries could be detected and resolved in a timely manner.

Findings Summarized by Operator:

	Child Care Operators				
	Operator A	Operator B	Operator C	Operator D	Operator E
Rationale for distributing GOG funding not reasonable and equitable.	X	X		X	X
The reconciliation was inaccurate/contained errors		X	X*	X	X
Conflict of Interest (not reported to City)	X	X			X
Incorrect recording of children attendance	X		X	X	X
Executive Director/owner paid GOG - role not defined, no timesheets	X			X	X
Insufficient Segregation of Duties	X	X		X	

*Minor error detected, was immediately resolved by Operator.

General Operating Grant (GOG) Findings

1. For four out of the five operators (80%), the rationale for distributing GOG funding was not reasonable and equitable.
2. The reconciliation template submitted by four out of the five operators was incorrect or contained errors. For two of these four operators, the reconciliation template contained inaccurate information (such as hours worked and GOG/hour rate); resulting in overstating the amount of GOG distributed to employees by approximately \$48,000. This amount could not be validated or reconciled with employee paystubs.
3. There was conflict of interest situations in three out of the five operators reviewed. These conflicts of interest were not reported to the City, which is in non-compliance with the funding agreement.
4. For four out of the five operators (80%), there were errors in the reporting of Children attendance to the City.
5. For three out of the five operators, Executive Directors were allocated GOG of approximately \$23,000. The Executive Directors/Owners eligibility of the funding couldn't be substantiated, their timesheets were not maintained, and their role was not defined.

6. In three of the five operator locations, there was insufficient segregation of duties. For example, in one location the Executive Director was the only bank signatory at the center and thus responsible for signing off staff salaries, including his own and other family members.

Wage Enhancement Grant (WEG) Findings

Owing to the more defined guidelines by the province, there were fewer discrepancies noted in the WEG funding distribution. We noted one instance where the staff hours were incorrectly calculated (the operator was including statutory holidays) resulting in overpayment to the operator of WEG by \$1,100.

Attendance Reporting Findings

As part of the audit guide and checklist work, we compared the Record of Attendance (ROA) attendance submitted to the City and the timesheets maintained at the location and noted anomalies in four out of the five operators reviewed. Operators were either incorrectly entering data (such as vacation days marked as sick days in ROA) or incorrectly reporting (child was absent but marked as present on ROA). There was a high volume of both types of anomalies.

RECOMMENDATIONS FOR MANAGEMENT

Following are recommendations that Management can consider for mitigating the deficiencies identified.

1. City Guidelines for General Operating Grant (GOG) Funding Needs to Be Strengthened and Revised

Revise the City guidelines on GOG funding to provide clarity on the following:

- A clear definition of what constitutes an 'equitable' and 'reasonable' distribution of GOG. The operator should be requested to establish a formal rationale for GOG distribution.
- Clear guidance on whether Executive Directors should be drawing from GOG funding. If so, outline what criteria must be met (for example defined roles, timesheets maintained, etc.)
- Clear guidance on whether supply staff at operator locations should be allocated GOG. We noticed variation across operators on how GOG was distributed to supply staff. Some operators were not giving any GOG to supply staff, even though the supply staff were working a high volume of hours.

- Highlight the importance (and requirement) of maintaining and retaining key documents which will be used during City's reconciliation process (such as staff timesheets).
- How the reconciliation should be completed by an operator. Improvements are required in the completion of the reconciliation template by operators. We noticed some operators were listing multiple staff on the same line and accumulating their total hours. This makes it difficult for the team in Children's Services to validate the total hours worked. Operators should be required to list each staff member on a separate line based on their role.

2. Conflict of Interest Needs to Be Monitored

As per the funding agreement, there should be no conflict of interest in the use of funds and disclosure should be made to the City if there was any actual, potential or perceived conflict of interest.

There were multiple instances where there was conflict of interest at the operator locations (such as parents approving their own and their children's' GOG). There is currently no mechanism within the City to monitor conflict of interest.

Management needs to understand and interpret the definition of conflict of interest as stated in the funding agreement and assess the risk of conflict of interest at operator locations. Given the amount of conflict of interest noted in the sample of operators selected, it is reasonable to conclude that conflicts of interests will be pervasive across operators funded by the City.

3. The Mid-Year and Annual Reconciliation Process Needs to Be Formalized

An audit guide and checklist template for this purpose has been created collaboratively by the OCA and Children's Services. It is recommended that Children's Services utilize these documents and regularly conduct reviews of the reconciliation process. The staff assigned to this task should validate and reconcile the submission with supporting documentation on a sample basis and expand the sample if anomalies are detected.

Examples of supporting documentation can include payroll summaries, T4's, general ledger statements, timesheets, etc.

4. Program Analysts Require Training

In 2018, a portion of the GOG funding (up to 25%) can be utilized by the child care operators for their operating expenses. As part of the audit, we reviewed the financial statements of the operators to assess the reasonableness of the operating costs which were covered by GOG funding. We noted instances where the operating costs were used for items not reasonably justified by a child care operator (for example, a non-profit operator reporting losses on their income statement but purchasing a higher-end vehicle).

The Program Analysts also review the operating costs as part of the annual service contract review of the operator; where they review the financial statements of each operator to determine the fee subsidy rate. We noted that there was no formal process for reviewing the financial statements submitted by the operators. The Program Analysts are not currently trained to identify and detect financial statement anomalies.

In one operator audit, where the child care operator was operating within a Church, the expenses for the child care operator and Church were consolidated and reported in the annual contract review (instead of only the operator expenses being reported). This affected the fee subsidy rate the City pays the operator annually, to the benefit of that operator.

The Program Analysts need to be given guidance on how to perform a high level financial statement review. Operating expenses should be reasonable and justifiable and supporting documentation should be reviewed if any anomalies are identified. It is recommended the Children's Services request advice from their Finance and Administration team to support this effort.

Program Analysts should understand how operators are organized administratively and the flow of funds within the operator's organization. The Program Analyst should assess that adequate segregation of duty exists, and that supporting organizational by-laws and board meeting minutes are properly maintained. Moreover, the Program Analysts should use critical thinking and professional judgement to ensure accuracy and consistency of information between the reconciliation and the terms contained in the annual service contracts.

Consideration should be given to incorporating an assessment of financial skills as part of the recruitment process when filling Program Analyst vacancies to ensure that qualified individuals are filling these positions.

5. Record of Attendance Requires Review

Operators' record of attendance for children attending their operation should be periodically reviewed. The operators should be educated on the importance of accurate reporting of attendance and the potential impacts to their receipt of funding from the City.

6. Management Oversight of The Reconciliation Process Requires Improvement

Management oversight over the reconciliation process needs to be improved. Reconciliations completed by the Program Analyst should be reviewed and approved by Management as per a prescribed frequency, or on a sample basis to ensure accuracy and quality.

CONCLUSION AND NEXT STEPS

Based on the results of the five operator assessments, there are opportunities for improvement. The recommendations listed above will enable Management to implement these improvements.

Given that only a small number of operators were assessed with on-site audits, Management should conduct similar audits across other child care operators to ensure the accuracy of reconciliations.

In mid-2018, the OCA completed a risk assessment of the Children's Services. The OCA conducted interviews to facilitate the identification of 16 risks facing the Children's Services, internal and external factors contributing to those risks, and controls and mitigations currently in place to manage those risks.

"Financial Controllershship" was one of the risks identified during the risk assessment. Management chose to not address this risk, the rationale provided was that controls were in place.

Based on the five operator assessments completed, we conclude that the current controls are not effective and need improvement. As a result, this risk will be ranked as a higher priority risk and Management will need to develop an action plan to mitigate the identified issues.