

**CITY OF HAMILTON**

**CITY MANAGER'S OFFICE**  
**Audit Services Division**

<b>TO:</b> Chair and Members Audit, Finance and Administration Committee	<b>WARD(S) AFFECTED:</b> CITY WIDE
<b>COMMITTEE DATE:</b> November 23, 2011	
<b>SUBJECT/REPORT NO:</b> Implementation of the Hybrid Auditor General Model (AUD11028) (City Wide)	
<b>SUBMITTED BY:</b> Ann Pekaruk Director, Audit Services City Manager's Office	<b>PREPARED BY:</b> Ann Pekaruk 905-546-2424 x4469 Lisa Pasternak 905-546-2424 x7294 Lisa Zinkewich 905-546-2424 x2297
<b>SIGNATURE:</b>	

**RECOMMENDATION**

- (a) That Report AUD11028 respecting the implementation of the hybrid Auditor General model be received;
- (b) That the by-law appointing the Director of Audit Services as the Auditor General attached as Appendix "A" to Report AUD11028, which has been prepared in a form satisfactory to the City Solicitor, be passed;
- (c) That the Internal Audit Charter approved by Council on January 26, 2011 be repealed and replaced by the Audit Services Charter attached as Appendix "B" to Report AUD11028;
- (d) That the Director of Audit Services be directed to carry out a three year pilot project conducting value-for-money audits as approved by Council in the annual work plan; and
- (e) That the Director of Audit Services report back to the Audit, Finance and Administration Committee on the pilot during its third year.

**EXECUTIVE SUMMARY**

At the June 8, 2011 Audit, Finance and Administration Committee, staff were asked to prepare a report respecting an implementation plan for a hybrid Auditor General Model. This model, which was to include a by-law and terms of reference, would assign the powers of an Auditor General to the Director of Audit Services, in addition to expanding the scope of work under Audit Services to include value-for-money (VFM) auditing.

Report AUD11028 highlights this implementation plan and includes the by-law, a revised Audit Services Charter (i.e. terms of reference) along with an estimate of required resources.

By combining the compliance / control and VFM auditing under Audit Services, effective audit processes can result in paybacks to the City in terms of increased revenue, reduced costs, improved internal controls, operational efficiencies, quality and effectiveness of services to citizens and enhanced protection of City assets.

The added powers and protections provided to the Director of Audit Services (by appointment as an Auditor General) strengthens the position of independence and institutional security of the Director while providing information to Council for its oversight role.

***Alternatives for Consideration – See page 6.***

**FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)**

**Financial:** Upon approval to add the value-for-money (VFM) auditing component into Audit Services' scope of work, additional annualized funding for staffing (salaries, benefits, training, equipment and supplies) would be required and is estimated at approximately \$261,300. Additionally, it is prudent to include an annual budget of \$25,000 to allow for the retention of outside consultants in areas audited for which the auditors do not have expertise. As well, a one-time cost for two workstations would be required, estimated at approximately \$10,000. Therefore, the total requested annualized increase in the Audit Services budget is \$286,300 plus a one-time cost of \$10,000.

**Staffing:** In order to carry out the VFM auditing program under Audit Services, it is suggested that two FTE staff be initially added to the complement. The two FTE staff referred to in this paragraph for the VFM auditing program are outside the funding for two additional staff which Council (April 7, 2011 General Issues Committee – AF&A Budget Report 11-003) has directed management to find for carrying out current audit work (see \* under the organization chart on page 6).

**Legal:** In order to appoint the Director of Audit Services as an Auditor General under Section 223.19 of the *Municipal Act*, Legal Services has drafted a by-law which is attached as Appendix "A" to Report AUD11028.

**HISTORICAL BACKGROUND** (Chronology of events)

On June 8, 2011, subsection (e) of Report CM11006 (subsequently tabled as indicated below) was amended by the Audit, Finance and Administration Committee by deleting the words “as part of” and replacing them with the words “be referred” to read as follows:

“(e) That the current staff complement in Audit Services be increased by 2 FTE’s, to accommodate value-for-money audits, and be referred to the 2012 budget process for consideration.”

The following motion was also passed at the June 8, 2011 meeting of the Audit, Finance and Administration Committee:

“That Report CM11006, respecting the Auditor General Model, be tabled, as amended, pending the Audit, Finance and Administration Committee’s receipt of a report respecting the Implementation Plan for the hybrid Auditor General Model, which is to include a by-law and Terms of Reference.”

**POLICY IMPLICATIONS**

*Municipal Act* (Section 223.19 - .23)

The existing Internal Audit Charter will be replaced with Appendix “B” to Report AUD11028.

**RELEVANT CONSULTATION**

Other municipalities’ structures and mandates relating to Auditor General were reviewed.

City of Hamilton staff from Audit Services, Legal Services and the City Manager’s Office were involved in writing this report.

**ANALYSIS / RATIONALE FOR RECOMMENDATION**

(include Performance Measurement/Benchmarking Data, if applicable)

In order to implement the hybrid Auditor General Model concept (i.e. the provision of the powers of an Auditor General to the Director of Audit Services and the expansion of the scope of work under Audit Services to include value-for-money auditing), the following items need to be considered and actioned:

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(a) By-law

Legal Services has drafted a By-law (attached as Appendix “A” to Report AUD11028) for appointing the Director of Audit Services as an Auditor General under Section 223.19 of the *Municipal Act*. The passing of this By-law by Council provides the Director of Audit Services with various powers, duties and protections (Sections 223.19 – 223.23 of the *Municipal Act*) without the formal title change to Auditor General.

(b) Audit Charter (Terms of Reference)

An Audit Charter was approved by Council in January, 2011 as part of Report AUD11005. In order to accommodate the extra duties from the appointment of the Director of Audit Services as an Auditor General, the Charter has been updated and is attached as Appendix “B” to Report AUD11028. The primary changes include:

- Under Introduction, the addition of a second paragraph – “In the capacity of Auditor General, the Director of Audit Services is responsible for assisting City Council in holding itself and its administrators accountable for the quality of stewardship over public funds and for the achievement of value-for-money in City operations.”
- Under Responsibilities, the addition of a bullet reading – “Carry out value-for-money (VFM) / performance audits to determine the efficiency and effectiveness of services and evaluate attainment of corporate objectives and value to citizens.”

The above additions will now give the Director added responsibility for value-for-money audits.

(c) Resources

Value-for-money audits are labour and time intensive. While the need for compliance and control audits clearly still exists in the City and the desired work plan cannot already be fully carried out due to staffing constraints, additions to the existing audit staff complement is warranted. In addition to the funding for the two staff auditors already being sought for compliance and control audits, a further two performance auditors are also required.

The initial recruitment of the two performance auditors at a cost of \$261,300 (including salaries, benefits, supplies, equipment and training) and a one-time cost of \$10,000 (for workstations) is required to carry out the VFM auditing program. In placing the VFM or performance auditors under the Director of Audit Services, costs are estimated to be less than for the establishment of a separate Auditor General’s office and provide the best balance between the achievement of VFM auditing of City operations and the fiscal constraints of financial resources.

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The existing Director of Audit Services would provide direction and supervision to the group of new auditors (as well as the established internal auditors) and the current Administrative Assistant would carry out the day-to-day administrative and support functions for the entire group. Placing the performance auditors in Audit Services has the advantage of building upon some of the existing expertise and documentation already existing in the Division.

The Director will also need full authority to engage consultants within the City's overall rules and purchasing policies. An amount of \$25,000 annually is initially recommended to be available, as needed, depending on the subject of the VFM audit.

(d) Work Plan

The Audit Services Division would continue to carry out compliance and financial control reviews (as it does now) and VFM audits would be added to the work plan as a separate section of work. Annually, the Director of Audit Services would prepare an Audit Work Plan and present it to the Audit, Finance and Administration Committee. After considering the results of the most recent risk assessment, the Director will decide which areas should be audited / reviewed.

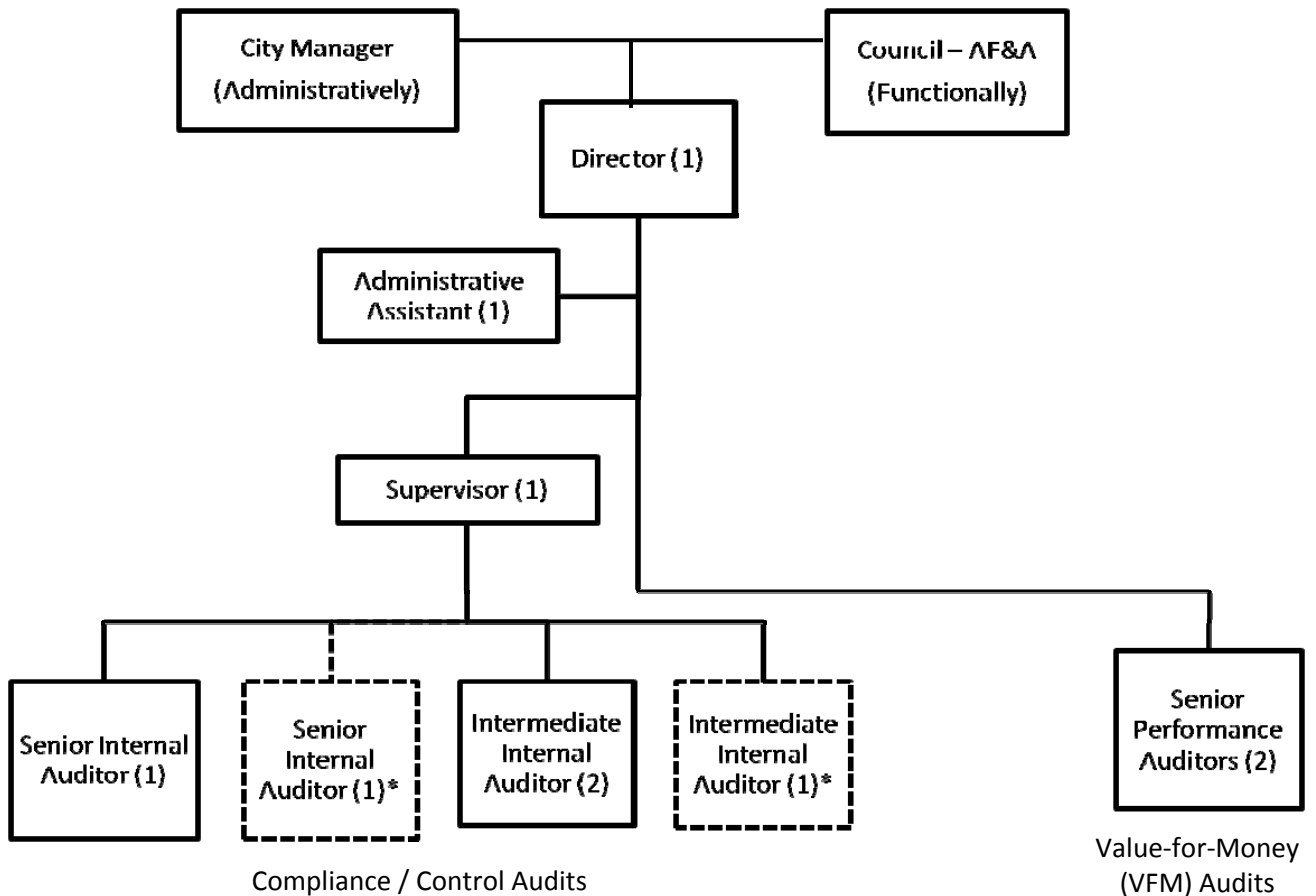
Council can request that the Director carry out a certain audit but the number of such requests should be controlled so that the auditor is not prevented from carrying out the work he/she feels is a priority or is likely to give the greatest payback. The Director's independence and neutrality should not be put in question. A formal policy or rules governing requests for special audits by individual members of Council or by Council itself emphasizing a simple two-thirds majority level of consensus required and giving the Director of Audit Services the latitude in accepting / not accepting to carry out such audits should be adopted.

(e) Term

A three year pilot for the VFM audit program is recommended. It is important to make the term long enough in order to attract experienced, skilled performance auditors as well as allow for an adequate duration to assess the structure and the results of the VFM program. In the third year of the project, the Director of Audit Services will report back to the Audit, Finance and Administration Committee with a summary of the work completed.

(f) Reporting Structure

The reporting relationship of the Director of Audit Services would essentially remain the same as it exists today, i.e. functionally, reporting to Council through the Audit, Finance and Administration Committee and administratively to the City Manager. This would apply to individual audit reports as well as to budgets and annual work plans. Under the Director of Audit Services, there would be two separate units – one responsible for carrying out the VFM audits and another responsible for compliance and control audits.



\*The two FTE staff positions outlined by dotted lines represent the additional resources being sought in the 2012 budget process for compliance and control audits. These auditors are separate from the two staff identified as Senior Performance Auditors required to carry out VFM auditing.

**ALTERNATIVES FOR CONSIDERATION**  
 (include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

Various Auditor General model alternatives were identified as part of Report CM11006 (presented to the Audit, Finance and Administration Committee on June 8, 2011). At that meeting, staff were directed to bring forward an implementation plan for the hybrid Auditor General model (Alternative 1 of Report CM11006). As such, the alternatives for the implementation of this model are noted below.

In the hiring of two performance auditors, there are two options that should be considered.

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- (1) Present the budget and complement increase to Council as part of the 2012 budget for consideration. If approved, then begin the hiring process thereafter (expected to be 2-3 months for job description development, posting, interviewing and hiring). This would give a mid-summer start to the VFM audit program, resulting in the completion of very few such audits in the first year.
- (2) Approval by Council to begin the hiring process immediately. This would allow to have staff on board and ready to proceed near the beginning of the 2012 year. This is being recommended to allow for close to a full year of work to be carried out. However, this would require Council to reconsider recommendation (e) of the June 8, 2011 report (CM11006) to Audit, Finance and Administration Committee which stated "That the current staff complement in Audit Services be increased by 2 FTE's, to accommodate value-for-money audits, and be referred to the 2012 budget process for consideration."

**CORPORATE STRATEGIC PLAN (Linkage to Desired End Results)**

Focus Areas: 1. Skilled, Innovative and Respectful Organization, 2. Financial Sustainability, 3. Intergovernmental Relationships, 4. Growing Our Economy, 5. Social Development, 6. Environmental Stewardship, 7. Healthy Community

***Financial Sustainability***

- ◆ Delivery of municipal services and management of capital assets/liabilities in a sustainable, innovative and cost effective manner.

**APPENDICES / SCHEDULES**

Appendix "A" – By-law to Appoint the Director of Audit Services as an Auditor General

Appendix "B" – Updated Audit Services Charter

ap:dt

**Authority:** Item ,  
General Issues Committee  
Report 11- AUD11028  
CM:

**Bill No.**

## **CITY OF HAMILTON**

**BY-LAW NO. \_\_\_\_\_**

### **To appoint the Director of Audit Services as an Auditor General under Section 223.19 of the *Municipal Act, 2001***

**WHEREAS** Council wishes to appoint the Director of Audit Services as an Auditor General under section 223.19 of the Municipal Act, with the responsibilities, including the powers, duties and protections, under Sections 223.19 to 223.23 of the Municipal Act;

**AND WHEREAS** sections 223.19 to 223.23 of the Municipal Act provide that an appointee under section 223.19 has certain powers, duties and protections, including: the powers to access information and to examine persons under section 33 of the *Public Inquiries Act, 2009*; the duty to preserve secrecy with respect to all matters that come to their knowledge in the course of performing their functions; and the protection of not being a competent or compellable witness in a civil proceeding;

**NOW THEREFORE** the Council of the City of Hamilton enacts as follows:

#### **Definitions**

1. In this By-law:

**"Council"** means the City of Hamilton's Council;

**"Director of Audit Services"** means the City of Hamilton's Director of Audit Services or their successor;

**"Municipal Act"** means the *Municipal Act, 2001*;



## Appointment

2. Council appoints the individual holding the position of Director of Audit Services as an Auditor General under section 223.19 of the Municipal Act, with the responsibilities, including the powers, duties and protections, under sections 223.19 to 223.23 of the Municipal Act.
3. The position of Director of Audit Services shall continue with the title of Director of Audit Services and all references to an Auditor General under sections 223.19 to 223.23 of the Municipal Act shall be deemed to be references to the Director of Audit Services.
4. The Director of Audit Services shall act in accordance with the Audit Services Charter, as approved by Council from time to time, with necessary modifications when a responsibility, including a power, duty or protection, under sections 223.19 to 223.23 of the Municipal Act is exercised.

## General Provisions

5. This By-law may be referred to as the Director of Audit Services By-law.
6. This By-law comes into force on the day it is passed.

**PASSED** this                      day of                      , 20 .

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R. Bratina  
MAYOR

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R. Caterini  
CITY CLERK

## **CITY OF HAMILTON AUDIT SERVICES CHARTER**

### INTRODUCTION

Audit Services provides independent, objective assurance and consulting services designed to add value and improve the City of Hamilton's operations. Audit Services brings a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

In the capacity of Auditor General, the Director of Audit Services assists City Council in holding itself and its administrators accountable for the quality of stewardship over public funds and for the achievement of value-for-money in City operations.

### SCOPE

The scope of Audit Services encompasses the examination and evaluation of the adequacy and effectiveness of the City's governance, risk management process, system of internal control structure and the quality of performance in carrying out assigned responsibilities to achieve the organization's goals and objectives. This includes conducting value-for-money audits. The City's processes should function in a manner to help ensure:

- Risks are appropriately identified and managed.
- Significant financial, managerial and operating information is accurate, reliable and timely.
- Actions are in compliance with policies, standards, procedures and applicable laws and regulations.
- Resources are acquired economically, used efficiently and are adequately protected.
- Programs, plans and objectives are achieved.
- Significant legislative and regulatory issues impacting the City are recognized and addressed properly.
- Quality and continuous improvement are fostered in the organization's control processes.

The Director of Audit Services has been appointed by by-law as an Auditor General under Section 223.19 of the *Municipal Act, 2001*, with the responsibilities, including the powers, duties and protections, under Sections 223.19 to 223.23 of the *Municipal Act, 2001*. These responsibilities apply to the extent authorized by Sections 223.19 to 223.23 of the *Municipal Act, 2001*.

### CONSULTING

In addition to audit engagements, staff of Audit Services may provide advisory or other consulting services, as appropriate, or at the request of Council or senior management. These types of services may include:

- Conducting special projects, reviews or investigations;
- Performing research;
- Providing training on audit related topics such as risk assessment and internal controls; or
- Providing counsel or advice (e.g. on the adequacy of draft procedures).

## AUDIT SERVICES CHARTER

AUTHORITY

Audit Services is granted full, free and unrestricted access to any and all records, property and personnel relevant to any function under review. Access to personal information is provided for under the *Municipal Freedom of Information and Protection of Privacy Act* (in particular, Subsections 31(c) and 32(d)).

Audit Services has the authority to conduct audits and reviews of all City departments, Members of Council, agencies, boards and commissions, as well as other entities the City is related to or has an interest in.

All employees shall assist Audit Services in fulfilling its objectives.

Audit Services, through the appointment by by-law of the Director of Audit Services as an Auditor General, has the responsibilities, including the powers, duties and protections, under Sections 223.19 to 223.23 of the *Municipal Act, 2001* for:

- City Departments;
- Members of Council;
- Local boards (not including the Board of Health, the Hamilton Public Library Board, the Police Services Board or other local boards in accordance with the definition of "local board" under Section 223.1 of the *Municipal Act, 2001*);
- Municipally-controlled corporations (a corporation that has 50 per cent or more of its issued and outstanding shares vested in the City or that has the appointment of a majority of its board of directors made or approved by the City, no including a corporation established in accordance with Section 203 of the *Municipal Act, 2001*); and
- Grant recipients.

These responsibilities under Section 223.19 to 223.23 of the *Municipal Act, 2001* include the powers to access information and to examine persons under Section 33 of the *Public Inquiries Act, 2009*; the duty to preserve secrecy with respect to all matters that come to its knowledge in the course of performing its functions; and the protection of not being a competent or compellable witness in a civil proceeding.

INDEPENDENCE

Independence is an essential component to building public trust and preserving objectivity and integrity associated with the audit function.

To provide for the independence of Audit Services, its personnel report to the Director of Audit Services, who reports administratively to the City Manager and functionally to the Audit, Finance and Administration Committee of Council. Audit and review reports are sent directly to the Audit, Finance and Administration Committee for discussion and approval and then to Council. These reporting relationships help ensure independence, promote comprehensive audit objectivity and coverage and assure adequate consideration of audit recommendations.

All Audit Services activities shall remain free of influence by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing or report content to permit maintenance of an independent and objective attitude necessary in rendering reports.

Audit Services shall have no direct operational responsibility or authority over any of the activities it reviews. Accordingly, it shall not develop nor install systems or procedures, prepare records or engage in any other activity which would normally be audited.

## AUDIT SERVICES CHARTER

RESPONSIBILITIES

The Director of Audit Services and the staff of the Audit Services division have the responsibility to:

- Review operations within the City at appropriate intervals to determine whether planning, organizing, directing and controlling are in accordance with management instructions, policies and procedures and in a manner that is consistent with both City objectives and high standards of administrative practice.
- Determine the adequacy and effectiveness of the systems of internal accounting, financial and operating controls.
- Review the reliability, utility and integrity of financial information and the means used to identify, measure, classify and report such information.
- Review the established systems to ensure compliance with those policies, plans, procedures, laws and regulations which would have a significant impact on operations and reports and determine whether the organization is in compliance.
- Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- Carry out value-for-money (VFM) / performance audits to determine the efficiency and effectiveness of services and evaluate attainment of corporate objectives and value to citizens.
- Report to those members of management who should be informed or who should take corrective action, the results of audit examinations, the audit opinions formed, and the recommendations made.
- Evaluate any plans or actions taken to correct reported conditions and provide timely follow-up to ensure satisfactory disposition of audit findings in the manner and timeframe committed to by management in the original audit report. If the corrective action is considered unsatisfactory, hold further discussions to achieve acceptable disposition.
- Develop a flexible annual audit plan, including any risks or control concerns identified by management or other audits as well as appropriate special tasks or projects requested by management.
- Undertake investigations or refer issues to other appropriate parties as a result of disclosures under the Whistleblower By-law.
- Maintain a professional audit staff with sufficient knowledge, skills and experience.

AUDIT PLANNING

Each year, the Director of Audit Services shall prepare a work plan, setting out the proposed schedule of audits and other undertakings proposed for the coming year. For the compliance / control audit plan, the following sources are considered:

- Prioritization of the audit universe using a risk-based methodology;
- Requests from Members of Council, senior management and staff;
- Any audits planned for the past year but delayed or not completed; and
- Any conditions or concerns discovered or communicated throughout the past year.

## AUDIT SERVICES CHARTER

Similarly, for planning the value-for-money audit candidates, the most recent risk assessment of services provided to citizens and areas likely to provide significant payback in terms of increased revenues, reduced costs, operations efficiencies and quality of services will be considered.

The annual work plan (divided into the two sections) will be presented to the Audit, Finance and Administration Committee for approval. Any changes to the work plan requested by Council or individual Members of Council will require a majority of at least two-thirds the total members of Council present and not prohibited by statute from voting for the Director of Audit Services to consider.

### REPORTING

A written report is prepared and issued by the Director of Audit Services following the conclusion of each audit. The report will include management's responses and the corrective action plans for specific findings and recommendations. Management's response will include a statement of general agreement or disagreement with the stated findings and recommendations as well as a timeframe for anticipated completion of action to be taken and an explanation for any recommendation not addressed.

Audit Services is responsible for appropriate follow up on audit findings and recommendations. All significant findings will remain open until the Director of Audit Services has determined management has appropriately taken action to resolve the finding.

All reports (whether compliance, control or VFM audits) are presented to the Audit, Finance and Administration Committee.