



# Report of the Auditor General of the Ville de Montréal to the City Council and to the Urban Agglomeration Council

For the Year Ended December 31, 2012

## Comments and Recommendations from the Auditor General

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## 1. Comments and Recommendations from the Auditor General

This year, as in past years, I am including a few comments and recommendations for the municipal administration in my introduction. This year, I felt it was appropriate to address the following topics of interest:

- Management of the ethics hotline and EPIM Squad (Escouade de protection de l'intégrité municipale);
- Commission of Inquiry on the Awarding and Management of Public Contracts in the Construction Industry (Charbonneau Commission);
- Avenues to explore for improving the city's management processes:
  - Risk management,
  - Expected levels of service,
  - Infrastructure project planning,
  - Three-year capital expenditures program (TCEP),
  - Accountability mechanisms,
  - Follow-up of the auditor general's recommendations;
- Follow-up on the distribution of contracts awarded by authorities to contractors;
- Auditor general's budget;
- Securing the Bureau du vérificateur général's email service and computer network.

### Management of the Ethics Hotline and the EPIM Squad

On October 17, 2012, I asked city council members in a letter to reconsider their decision of December 2010 to transfer the responsibility of managing the ethics hotline from the Bureau du vérificateur général (BVG) to the Service du contrôleur général. This request was justified by the current climate, in which Ville de Montréal (the city) has been beset by allegations of collusion, corruption and misappropriation of funds since the opening of hearings of the Commission of Inquiry on the Awarding and Management of Public Contracts in the Construction Industry. I still believe that this decision would help raise the level of trust that city employees and the general public place in the municipal administration. My thinking was based on the following main arguments:

- The particular status of the auditor general: as a city council officer, the auditor general is independent, neutral, impartial and free of ties to the administration. People who want to make a report would feel more confident about giving it to the BVG;

- The Service du contrôleur général is subordinate to the authority of the city manager. This relationship could present a conflict of interest if allegations were levelled against the city management;
- Unlike the BVG, the Service du contrôleur général does not have the power to audit or investigate bodies under the city's jurisdiction, such as the Société de transport de Montréal (STM) or the Société d'habitation et de développement de Montréal (SHDM), which are exempt from works conducted by the Service du contrôleur général;
- The provisions of the *Cities and Towns Act* explicitly guarantee the confidentiality of any reporting to the BVG. Fraud or favouritism very often involves the participation of people on the inside and on the outside. The ethics hotline is designed specifically to enable employees, suppliers and citizens to report any wrongdoing in complete confidentiality;
- In other Canadian cities, an increasing number of reports are made to ethics hotlines every year, which is the opposite of what has happened in Montréal since the line was transferred to the Service du contrôleur général. For instance, in Toronto, the number of reports surged from 157 in 2002 (the first year in which the ethics hotline was used) to 822 in 2011, while in Ottawa the number of reports rose from 48 in 2005 to 182 in 2011. For Montréal, in 2010 (the first year in which the auditor general was responsible for the ethics hotline, for a 13-month period), the BVG received 131 reports, whereas only 33 reports were received in 2011 (under the direction of the Service du contrôleur général). We also want to stress that in all other Canadian cities with an ethics hotline, it is under the authority of the auditor general.

#### Recommendation

**I remain convinced that it is in the city's interest to entrust the BVG with the responsibility of managing the ethics hotline. Accordingly, I reiterate the request I made to city council last October 17, which was that responsibility for the ethics hotline be transferred to the BVG.**

I was also informed of the creation of the EPIM Squad on January 11, 2013, which is mandated to protect the municipal integrity of the Ville de Montréal, particularly with regard to the contract awarding process. The Service de police de la Ville de Montréal (SPVM) was appointed to create and manage this new squad. A dedicated telephone line and an email account were set up for employees to pass on information to the EPIM in complete confidentiality.

Since then, the BVG has remained in contact with the EPIM to coordinate our respective duties with a view to efficiency and effectiveness.

## Commission of Inquiry on the Awarding and Management of Public Contracts in the Construction Industry (Charbonneau Commission)

The allegations made before the Commission of Inquiry on the Awarding and Management of Public Contracts in the Construction Industry (Charbonneau Commission) concerning activities involving collusion and corruption in the municipal administration of Montréal are disquieting. According to allegations made at the Charbonneau Commission hearings, an organized system has been in place for several years to divert funds from the city's coffers to organized crime, political parties, suppliers, elected officials and employees. This system would include complex overbilling schemes, falsification of documents and tacit complicity. It appears that several people at different levels in the city's chain of command could be directly involved in the alleged schemes.

For many years the BVG conducted audits for the purpose of detecting and preventing activities of collusion or corruption. I would like to present an overview of the audits of the contracting process that the BVG conducted over the past 15 years to show that the auditor general, within the scope of his responsibilities, repeatedly sounded the alarm. This is not an exercise in self-justification, but an account of the audits that the BVG conducted with a critical approach to the risks of collusion or corruption and with a desire to understand the particular context in which the alleged collusion and corruption became entrenched in the city.

Auditors have a twofold responsibility with respect to fraud. First, they fulfil a preventive function by formulating appropriate recommendations following audits in an attempt to limit opportunities for fraud. Auditors also fulfil a function of fraud detection, insofar as possible, provided that evidence has come to light as a result of audits or whistleblowing. It is important to understand that collusion and corruption are among the most difficult types of fraud to detect. They result from secret agreements involving schemes that are often implemented at a point in the process that occurs ahead of the organization's internal control mechanisms. The allegations made before the Charbonneau Commission show the presence of all the elements of collusion and corruption in combination, which are extremely difficult to detect during a traditional audit. In fact, there are probably three types of schemes in use:

- Internal collusion involving several people who are part of the chain of command;
- Corruption of public officials and elected officials by organizations with interests in the city;

- Outside collusion of various firms for the purpose of creating market-sharing cartels for contracts and price-fixing.

Through its audit reports, the BVG has repeatedly had an impact over the past 15 years on controls used to prevent fraud by urging that the following measures be implemented:

- Division of duties among key stakeholders;
- Documentation of variances between cost estimates and the lowest bids;
- The level of care the city must exercise in producing the most accurate estimates possible and in keeping them confidential;
- Spot checks of supervision of projects entrusted to outside firms to ensure that the city pays only for work actually performed;
- Follow-up on project implementation and control of contingencies (commonly called “extras”);
- Cost comparisons with comparable work in previous years or similar work performed by other boroughs;
- Production of relevant information so that authorities can make informed decisions.

As early as 1997, the auditor general noted that a limited number of suppliers shared the Montréal market (two annual reports—1997 and 2001—discuss this issue). In 2009, I also observed the troubling market share of construction firms within some boroughs.

At that time, the BVG also perused a report released by the city’s internal auditor in November 2006, which has since then been submitted to the Charbonneau Commission. This report concluded that the city was not operating in a completely competitive environment and proposed appropriate recommendations to mitigate the risk of fraud. It should be noted, however, that the conclusions of this report did not uncover any acts of collusion or corruption. In fact, according to this report: *[TRANSLATION] “It should be noted that our observations were based on the results of tests conducted on a certain number of projects reviewed and would therefore not necessarily have led to the detection of fraud or any other illegal act if they ever existed.”*

Moreover, the BVG agreed with all the recommendations of the 2006 internal audit report. In my opinion, the measures recommended were appropriate for preventing fraud in contracting. The city accepted these recommendations, and action plans were produced and assigned to individuals in positions of authority in the city. The BVG reviewed those action plans, which were ratified by city officials, to implement the proposed actions.

In 2007, my predecessor noted that it would be unrealistic to believe that an auditor general could detect all fraudulent activity and recommended that the city set up an ethics hotline to

receive reports in complete confidentiality on any wrongful act that could be connected with fraud or waste. The hotline, as is well-known, was introduced at the end of 2009 by the BVG but was withdrawn in December 2010.

As I mentioned above, it would seem that the perpetrators of the corruption and collusion brought to light by the Charbonneau Commission probably used schemes that were, according to the information disseminated, highly complex, carefully planned and skilfully orchestrated, making them almost undetectable in a traditional audit, even for the most experienced auditor.

It should also be kept in mind that the scope of the BVG's audit and its findings is limited by four major factors:

- The auditor general does not have the police authorities' power to investigate;
- Unlike the Charbonneau Commission, which has the power to force members of various organizations to testify before it, the city's auditor general is empowered only to require that any employee of the city provide information necessary for the audit, and does not have the legal authority to demand information from elected officials or third parties or to force interviewees to explain themselves;
- By their very nature, collusion and corruption impose limitations on an organization's internal control. As long as there are people who decide to conspire to commit corruption or collusion, it becomes difficult, even very difficult, for an auditor to detect schemes implemented for this purpose;
- Funding provided to the auditor general is limited and set by law.

The auditor general has a far-reaching mandate that involves not just the regulatory compliance audit, but extends to certification of the city's financial statements, as well as those of bodies under its jurisdiction, and the value-for-money audit in different areas, such as services provided to citizens, infrastructure longevity, information technologies and management of human, material and financial resources.

In conclusion, I am convinced that an independent audit of the city's accounts and affairs, such as it is conducted by its auditor general, is still an important means of ensuring sound management of public funds. However, because of the abovementioned constraints, it would be unrealistic to expect the auditor general to be able to detect all fraudulent activity that could occur in a large city like Montréal. I have neither the powers nor the resources of a commission of inquiry or a police force. Furthermore, fraud is usually detected on the strength of disclosures by individuals who witnessed it. To this end, my investigative and forensic accounting team always follows up on tips it receives and, if need be, performs the necessary investigative work. When necessary, the case is referred to the police (see

chapter 3 of this report for more details). Also, in light of the revelations of the Charbonneau Commission, my office changed its auditing procedures to focus more on evidence that would help detect these offences.



## Avenues to Explore for Improving the City's Management Processes

In this section, I want to call attention to some of the BVG's findings that are intended to tighten and improve city management. I believe these findings will provide grounds for the city to adopt a position and for the municipal administration to take concrete actions.

### Risk Management

Several years ago the city developed a risk management grid that brought to light various risks that could jeopardize its activities. The municipal administration should promote the design of a new risk management grid that would take into account new parameters and certain key sectors (e.g., permits, professional fees, contracts) that are more at risk for embezzlement.

#### Recommendation

**I recommend that city council ensure that the city produce a new risk management grid to determine key sectors and activities that are more exposed to misappropriation of funds in order to increase surveillance and strengthen its internal controls, thereby preventing financial losses.**

### Expected Levels of Service

Audits conducted by the BVG led me to the conclusion that city authorities have made no decisions about desired levels of service (desired condition) for buildings or infrastructures, whether they involve the road system, bridges and tunnels or water systems. These expected levels of service are of vital importance because they define the parameters of the corresponding levels of investment. They are based on knowledge of the present condition of infrastructures and buildings in different categories, and they clearly depend on choices that authorities must make in the areas of reliability and safety. Since the city has made no clear commitments regarding levels of service, and given the budget constraints and limited resources available, the investment deficit can only rise, and infrastructures and buildings will continue to deteriorate.

### Recommendation

Given the present condition of the various asset categories for the city's buildings, road system, bridges, tunnels and waterworks systems, I recommend that city council take the necessary steps to ensure that:

- Levels of service are established for these infrastructures and buildings;
- These levels of service are submitted to and approved by authorities;
- Levels of investment that correspond to the approved levels of service are allocated over a long-term period;
- The city adopts a realistic funding method so that responses deemed necessary can be implemented.

## Infrastructure Project Planning

Infrastructure projects are complex undertakings that must be planned over a timeline of several years so that all urgent or high-priority tasks can be covered adequately. This planning also gives an overview of what needs to be accomplished over the next few years. However, audits conducted by the BVG led me to the finding that the planning is currently done on an annual basis, since TCEP budgets are uncertain from one year to the next, which makes it difficult to execute some projects.

### Recommendation

I recommend that city council take the necessary steps to ensure that infrastructure project planning is carried out over a period of several years in order to facilitate project implementation and help prioritize longer-term responses.

## Three-Year Capital Expenditures Program (TCEP)

The TCEP helps determine the budget available for the various high-priority capital projects. The city's various departments and boroughs need to know the content of the TCEP so that they can plan and coordinate projects for which they are responsible. I have identified important issues in this area that deserve the administration's attention.

First, I have noted that the TCEP is not approved early enough for business units (departments and boroughs) to be informed in a timely manner of budgets that will be allocated to them so that they can plan their projects accordingly. Business units are caught off guard and cannot begin necessary projects in time and take advantage of the lowest costs that might be offered by different contractors. In past years, authorities approved the TCEP in December. The TCEP for 2013 was approved in September 2012, which is an

improvement. Nevertheless, this step in the process is still carried out too late for business units to be able to implement their projects at the best possible cost.

#### **Recommendation**

**I recommend that city council take the necessary steps to ensure that adoption of the TCEP is scheduled earlier so that business units can plan their projects in a timely manner.**

Second, the municipal administration does not verify business units' capacity to perform the work demanded of them. Business units have limited financial and human resources. The fact that the administration does not take these limits into account in establishing the TCEP is essentially tantamount to an expression of wishful thinking. In fact, audits conducted by the BVG showed that:

- The budget allocated to business units is not fully spent;
- A large number of planned projects are not executed in the year in which they are scheduled. Many projects originally scheduled for one year are carried over to subsequent years, which forces the implementation rate up drastically and greatly exacerbates the deterioration of infrastructures.

#### **Recommendation**

**I recommend that city council take the necessary steps to ensure that business units have the resources required to implement the projects provided for in the TCEP.**

### **Accountability Mechanisms**

Audits conducted by the BVG led me to the finding that the municipal administration does not always receive all the information it needs from business units to make informed decisions and discharge its governance responsibilities. For example, given the levels of investment allocated, the municipal administration does not receive periodic reporting on the condition of infrastructure and building assets. The municipal administration should make its accountability reporting needs clear to all business units. This would help establish high-priority or strategic issues on which it wishes to receive regular reporting.

**Recommendation**

**I recommend that city council take the necessary steps to ensure that business units are clearly informed of the high-priority or strategic sectors on which they must regularly report so that the municipal administration will obtain the complete information it needs to make informed decisions and fulfill its governance responsibilities.**

**Follow-Up of the Auditor General's Recommendations**

In 2012 I noted a certain laxness on the part of the municipal administration in implementing the recommendations outlined in the annual report for the year ended December 31, 2011. In fact, as the current report was going to press, a “completed” status applied to only 35% of the recommendations made in 2011, compared with 69% for recommendations made in 2010 at the same time last year.

**Recommendation**

**I recommend that city council take the necessary steps to ensure that business units follow up more rigorously on the auditor general's recommendations.**

## Follow-Up on the Distribution of Contracts Awarded by Authorities to Contractors

Audits conducted in 2009 in connection with the production of my annual report raised questions for me about the distribution of contracts awarded to contractors for projects to develop, rehabilitate and replace facilities and infrastructures. At that time I established that a sizeable proportion of the contracts awarded from 2006 to 2009 by borough councils, the executive committee, city council and the urban agglomeration council went to a group of 21 firms. More specifically, I reviewed the distribution of contracts that each borough council awarded to this group of 21 firms. For this period, the results of this review led to the finding that some boroughs were awarding a high percentage of their contracts to the same contractors within this group of 21 targeted firms.

Since 2009, the municipal administration has implemented an array of measures to tighten contracting rules, while, concurrently, new legislative provisions were introduced for the same purpose.

As mentioned in my 2009 annual report, I had committed to following up in fiscal 2011. This follow-up was performed and presented in the 2011 annual report. The work consisted of a review to verify whether the trend noted in 2009 was still evident in 2011. I excluded 2010 data from my review because 2010 was the year in which the municipal administration introduced measures and some of the legislative provisions were enacted. The results of this follow-up, which focused on the year 2011, showed a trend towards a more equitable distribution of contracts among the 21 firms, which led me to believe that the measures implemented by the municipal administration and the provincial legislature were producing results. However, I had planned to continue my review for 2012, 2013 and 2014 so that I could assess its merits with greater assurance.

Since January 1, 2012, new administrative and legislative measures have been in force. Some of them were adopted as a result of the revelations heard at the Charbonneau Commission, which opened on May 22, 2012. Here are a few of them:

- The requirement that any contractor wishing to enter into a construction contract of \$25,000 or more with a municipal body hold a certificate of compliance from Revenu Québec under the *Regulation respecting construction contracts of municipal bodies*,<sup>1</sup> which came into force on January 1, 2012. The certificate must confirm that the

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<sup>1</sup> *Gazette officielle du Québec. Part 2, Vol. 143, No. 35, August 31, 2011, pp. 3899-3901.*

company filed the returns required under tax laws and has no overdue account payable to the Minister of Revenu Québec.

- The creation of the register of enterprises ineligible for public contracts (RENA), which has been in force since June 1, 2012. The RENA is one of the measures the provincial legislature has adopted to ensure the probity of companies wishing to conduct business with the government. The names of companies that have been convicted of an offence under a law or regulation listed in the *Act respecting contracting by public bodies*,<sup>2</sup> including the *Criminal Code* and the *Income Tax Act*,<sup>3</sup> are recorded in the RENA. Accordingly, companies registered in the RENA cannot be awarded a public contract or subcontract or carry out such a contract for a maximum period of five years.
- The suspension of contracting for infrastructure work, which was ordered by the city's executive committee since October 3, 2012. This decision was motivated mainly by the new provincial government's desire to rapidly amend the scope of the *Act to prevent, combat and punish certain fraudulent practices in the construction industry and make other amendments to the Building Act*.<sup>4</sup> In this regard, my review of all the resolutions made by the executive committee, city council and the urban agglomeration council from that date until March 31, 2013, led me to conclude that no contract for infrastructure work was granted during this period.
- The coming into force of the *Integrity in Public Contracts Act*,<sup>5</sup> assented to on December 7, 2012, which requires that companies wishing to contract with a public body or municipality obtain prior authorization from the Autorité des marchés financiers (AMF) before entering into public contracts in order to safeguard transparency in contracting processes, the honest and fair treatment of tenderers, and the opportunity for qualified tenderers to participate in calls for tenders made by public bodies. The contracts to which this Act applies are construction, service and public-private partnership contracts and subcontracts that are executed as part of an infrastructure project equal to or greater than \$40 million, as well as certain contracts of Ville de Montréal, as determined by decree. To date, three decrees, each involving 25 bids, have come into force, one on January 15, one on February 13, and one on March 20, 2013. These are calls for tenders that the city wishes to pursue or issue and involve expenditures of less than \$40 million.

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<sup>2</sup> RSQ, chapter C-65.1.

<sup>3</sup> RSC, 1985, chapter 1 (5th supp.).

<sup>4</sup> SQ, 2011, chapter 35.

<sup>5</sup> SQ, 2012, chapter 25.

- An amendment to the contract management policy passed on December 17, 2012, which excludes companies that have admitted to taking part in collusion, corrupt practices or other offences of the same nature from the bidding process for a five-year period. Previously, such penalties could be imposed only when their liability was established under a final court decision. This amendment affects calls for tenders issued after that date.
  
- The announcement by the municipal administration on January 11, 2013, of the creation of the EPIM, which reports to the SPVM. This squad will be mandated to protect the administrative integrity of Ville de Montréal by handling all information, mostly crime-related, that it receives, particularly with regard to the tendering process. It will also introduce prevention and detection mechanisms for schemes and ploys that sully the contract tendering process. This mandate must extend to all municipal departments.
  
- The creation, on January 24, 2013, of the advisory committee on the granting of municipal contracts by the Ville de Montréal, chaired by Mr. Jacques Léonard. On May 8, 2013, the *Rapport du comité-conseil sur l'octroi et la gestion des contrats municipaux à la Ville de Montréal* has been tabled to the mayor. This report recommend notably measures for reviewing the rules for awarding contracts and their management, and ensure the effectiveness of internal and external controls as well as compliance with ethical standards.

Under the circumstances, in view of the recent implementation of these new administrative and legislative measures, I think it would not be very useful to repeat the task of following up on contracts obtained by the 21 firms originally targeted.

## Auditor General's Budget

In my last three reports, I discussed the problem of calculating credits granted to the auditor general under the *Cities and Towns Act*. I noted that calculation of my credits on the basis of the city's operating budget did not allow me to fully carry out my legal responsibilities, which include not only audits of the city's accounts and affairs, but also audits of bodies that are within the city's jurisdiction or are part of its reporting entity. The situation was even worse in 2012 because I had to assume the certification costs of several bodies that had been included in the city's reporting entity since January 1, 2011.

The issue changed appreciably in 2012, when the Commission permanente sur les finances et l'administration (the Commission) heard some of my grievances. The Commission's report, entitled *Rapport d'étude publique et recommandations sur le Rapport annuel du vérificateur général de la Ville de Montréal – Exercice 2011*, was submitted to city council on August 20, 2012. In the report, the Commission presented several recommendations, three of which concerned the auditor general's operating budget. These recommendations are given on page 12 of the report. They essentially concern two points:

- The audit fees charged to bodies that were already paying fees to have their financial statements certified by outside firms in 2011 and for which the BVG had to undertake certification activities in 2012. These bodies were:
  - Bixi Toronto Inc.;
  - Centres locaux de développement (CLDs);
  - Fiducie du Technoparc Montréal;
  - Office municipal d'habitation de Montréal (OMHM);
  - Société de jalonnement dynamique de Montréal;
  - Société de vélo en libre-service;
  - Société en commandite Stationnement de Montréal;
  - Technoparc Montréal.

For these bodies, the Commission formulated Recommendation R-3, which reads as follows:

*[TRANSLATION] [The Commission recommends] that the bodies listed continue to pay audit fees out of their operating budgets.*

I estimated that these fees totalled \$350,000, excluding CLDs.



- The certification costs paid by the BVG for the financial statements of municipal bodies that were already under my jurisdiction before the amendment to the *Cities and Towns Act* came into force on January 1, 2011. These bodies are:
  - Anjou 80;
  - Conseil des arts de Montréal;
  - Conseil interculturel de Montréal;
  - Corporation d'habitation Jeanne-Mance;
  - Office de consultation publique de Montréal;
  - Société de gestion Marie-Victorin;
  - Société de gestion du port de plaisance de Lachine<sup>6</sup>;
  - Société d'habitation et de développement de Montréal (SHDM);
  - Société du parc Jean-Drapeau.

For these bodies, the Commission formulated Recommendation R-4, which reads as follows:

*[TRANSLATION] [The Commission recommends] that paramunicipal bodies, the Société d'habitation [et de développement] de Montréal, the Société du parc Jean-Drapeau and the Commission des services électriques de Montréal, which form part of the city's reporting entity, pay all audit costs and fees out of their operating budget.*

Following analysis, I excluded the Commission des services électriques de Montréal from the list of bodies covered by this recommendation. I therefore estimated the total cost of the financial certification of these bodies in 2012 to be \$260,100.

Finally, the Commission formulated Recommendation R-5, which reads as follows:

*[TRANSLATION] [The Commission recommends] that in the event that recommendations R-3 and R-4 are not applicable, the Service des finances evaluate and consider the possibility of taking the funds to pay the auditor general's fees out of the budgets of the bodies concerned and placing them in the budget of the Bureau du vérificateur général.*

In September 2012 I approached the senior manager and treasurer of the city to enquire whether follow-up action was being taken on these recommendations. I indeed received credits of \$610,100, which were added to my budget for fiscal 2013, which was approved by city council as part of the procedure for adoption of the city's budget. These credits are

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<sup>6</sup> New name since August 15, 2012. Formerly the Société de gestion NauBerges de Lachine.

very useful for helping me fulfil my mandate properly. The senior manager and treasurer confirmed that these credits would be paid on a recurring basis.

I want to stress that the additional amount allocated to the BVG covers only costs and expenses related to the certification of financial statements of bodies under the city's jurisdiction, but does not cover the other two components of the auditor general' mandate for those bodies: the value-for-money and the regulatory compliance audits. This is why I recommended in 2009 that the consolidated budget rather than the city's operating budget be used as the basis for calculating the auditor general's credits. I am nevertheless thrilled with the progress that has been made, as well as with the Commission's and city council's responsiveness.

## Securing the Bureau du vérificateur général's Email Service and Computer Network

In 2012, the BVG carried out two major projects to make its communications and data more secure.

The first project was to transfer all BVG email boxes from the Lotus Notes email system to the Google Apps email system, creating its own domain name (bvgmtl.ca) in the process. The BVG enlisted the services of a specialized firm to assist with this transfer process. Google's security measures were analyzed in depth and considered sufficient to meet the BVG's needs.

The second project was to implement a new protected domain outside the city's domain so that it could assume full control of the BVG's network and server infrastructure. A connection with the city's internal network is still being maintained, but it is now controlled by the BVG. The BVG's network is now protected by a firewall under its control.