



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, 2014

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COMMENTS AND RECOMMENDATIONS FROM THE AUDITOR GENERAL



1. Comments and Recommendations from the Auditor General

As in past years, my introduction includes a few comments and recommendations for the City's administration. This year, I feel it is appropriate to address the following topics of interest:

- 1.1. Responses of the authorities to the auditor general's audit reports;
- 1.2. Rate of implementation of the recommendations issued by the Bureau du vérificateur général (BVG);
- 1.3. Maintaining the BVG's expertise;
- 1.4. Internal control deficiency observed during the audit of the consolidated financial statements of the Ville de Montréal for the year ended December 31, 2014;
- 1.5. Government transfers;
- 1.6. Audit of the financial statements of Technoparc Montréal.

1.1. Responses of the Authorities to the Auditor General's Audit Reports

One of the municipal administration's prerogatives is whether or not to implement the recommendations issued by the auditor general. Under the existing process, once the auditor general's annual report has been filed with the municipal council and the urban agglomeration council (the councils), the Commission permanente sur les finances et l'administration subjects the auditor general's annual report to public scrutiny and review. It then files a report on its recommendations with the councils. The councils take note of this report and forward it to the executive committee for the appropriate follow-up. The executive committee is required to provide the councils with a report responding to the recommendations made by the Commission permanente within a reasonable timeframe. The councils then take note once again of the executive committee's response.

In the past years, the Commission permanente has issued recommendations on specific topics addressed in the auditor general's annual report instead of on the audit reports as a whole. In turn, for the years where the executive committee issued a response to the recommendations of the Commission permanente, we note that it did not issue opinions on all of the audit reports contained in the auditor general's annual report. We also note that the councils acknowledge the recommendations made by the Commission permanente and the

response given to them by the executive committee, but that no authority actually issues an opinion on its intention to implement the auditor general's recommendations.

To reinforce the follow-up of the auditor general's recommendations and thus increase the rate of implementation of these recommendations, we believe that the Commission permanente sur les finances et l'administration should issue an opinion on each audit report contained in the auditor general's public annual report to enable the executive committee to do the same.

Recommendation

I recommend that the Direction générale take action with the authorities to have them issue an opinion on each audit report contained in the auditor general's annual report to reinforce the follow-up process and increase the rate of implementation of the recommendations.

1.2. Rate of Implementation of the Recommendations Issued by the Bureau du vérificateur général (BVG)

The BVG's policy is to follow up on the recommendations during the year that follows their publication in the annual report. For a given year, the cycle of following up on recommendations normally extends at most over a three-year horizon. Indeed, the BVG reasonably expects that 100% of the recommendations issued shall be implemented within this three-year horizon, except under very specific circumstances where certain recommendations are followed up during an additional year or two.

From 2001 until 2012, the rate of implementation of the recommendations issued by the BVG that were considered as "completed" or "underway" at the time the BVG had completed its follow-up work was measured against an annual objective set at 80% by the municipal administration. In 2013, the Direction générale de la Ville set new performance targets for implementing the BVG's recommendations. The business units were therefore to be evaluated in accordance with the following performance targets regarding the recommendations issued as of 2012:

- 70% of the recommendations issued must have been implemented by the end of the first year after they were issued;
- 90% of the recommendations issued must have been implemented by the end of the second year after they were issued.

In my 2013 Annual Report, I indicated that *the proportion of recommendations published in our 2012 annual report that were "completed," i.e., 43%, is well below the target of 70% set by the municipal administration.* Consequently, I recommended that the Direction générale take action "to raise awareness among the business units about the importance of implementing the recommendations issued by the Bureau du vérificateur général within a year's time, in most cases, and that this condition be taken into account in the action plans submitted."

Based on the 2013 Annual Report of the auditor general, the Commission permanente des finances et de l'administration issued recommendation R-1 stipulating:

[TRANSLATION] "that the City's administration see to following up on the auditor general's recommendations with the City departments and the boroughs so that they are implemented as quickly as possible and in accordance with the new performance targets set by the City's Direction générale in 2013:

- *70% of the recommendations made must have been implemented by the end of the first year after they were issued;*

- *90% of the recommendations issued must have been implemented by the end of the second year after they were issued.”*

At the December 15, 2014, municipal council meeting and the December 18, 2014, agglomeration council meeting, the executive committee filed the following response to this recommendation:

[TRANSLATION] The executive committee also believes that it is very important that the recommendations issued by the auditor general and retained by the municipal administration be implemented as quickly as possible. However, the executive committee questions the relevance of setting the performance targets described in R-1. Certain recommendations are more important from a strategic standpoint than others and must therefore be given priority. Some may be relatively easy to implement, whereas others will be easier to implement once the appropriate organizational changes have been made. The City must also maintain a certain level of administrative flexibility in order to be able to respond to other emergencies and priorities during the year and ensure its operations run smoothly.

Consequently, the executive committee asks that the Direction générale implement the relevant recommendations made by the auditor general by order of priority and at a pace that will optimize City management and continue to report yearly on the implementation of the recommendations.

During this municipal council meeting, the president of the executive committee declared that the goal was ultimately to respond to 100% of the issues raised by the auditor general and attempt to do so by order of priority. Furthermore, he indicated that he would submit a work plan (to be determined) in response to the priorities.

In this regard, we deem it appropriate to issue the following comments on the executive committee’s response and the clarifications provided by its president:

- Firstly, we are pleased by the willingness expressed by the president of the executive committee to implement 100% of our recommendations.
- With respect to “implementing the auditor general’s relevant recommendations by order of priority,” it is important to clarify that it is exceedingly rare that business units do not follow our recommendations. Also, priorities are already established when the business units prepare their action plans in response to our audit reports. Indeed, these action plans describe the actions proposed by the business units to address the deficiencies underlying our recommendations in accordance with a timeline that takes into consideration the scope of the required measures and the risks involved. Moreover, at

this stage, we make sure that the proposed actions meet the objectives underlying the recommendations issued in the audit report and that the timeline for implementing said actions is reasonable under the circumstances. If necessary, we ask the business units to provide us with revised action plans.

- I would emphasize that, in the vast majority of cases, the action plans submitted to us do not extend beyond one year.

Although we acknowledge that decisions regarding both the implementation of the recommendations and the terms of reporting to the councils on how the City follows up on the auditor general's recommendations remain the City's prerogatives, we nevertheless believe that these conditions should be based on objective criteria that enable the councils' members to obtain the information they need to fulfil all of their governance responsibilities.

Moreover, in light of the above, we maintain that the previously mentioned targets of 70% and 90% remain valid interim indicators for the purpose of globally assessing the extent to which the municipal administration is progressing towards the implementation of 100% of the recommendations within a three-year horizon. Indeed, a result that is significantly lower than the targets indicates that the business units are not fulfilling the commitment set out in the action plans they previously provided to us to ensure the implementation of our recommendations. Although we are aware that various other priorities may influence the order in which the business units fulfil their commitments, this situation nevertheless reveals a high risk that our recommendations will not be implemented during our three-year tracking cycle unless strict corrective measures are taken. In our opinion, it is important to develop indicators that enable the municipal administration to more easily identify cases of non-fulfilment in order to obtain explanations and ultimately determine the necessary corrective measures.

To this effect, we should point out that our follow-up work carried out for the purpose of this report reveals that the situation has not improved compared with the situation described in our 2013 Annual Report, in particular with respect to the recommendations we issued based on our resource and IT optimization audit. Indeed, the rate of implementation at the end of the first year of follow-up, as indicated in this annual report, is only 44% and was only 43% in last year's annual report, compared with the target set at 70%. Furthermore, the rate of implementation at the end of the second year of follow-up is only 65% for the recommendations made in 2012, compared with the target set at 90%.

In our opinion, this situation requires that corrective measures be taken as quickly as possible and that the Direction générale assert a certain leadership in this regard.

Recommendation

I recommend that the Direction générale take action as required under the circumstances to ensure that the business units' commitments as described in their action plans to ensure the implementation of the auditor general's recommendations are fulfilled.

Recommendation

I recommend that the Direction générale provide the councils, in response to the expressed needs, with accounts on the follow-up of the auditor general's recommendations to enable them to fulfil all of their governance responsibilities.

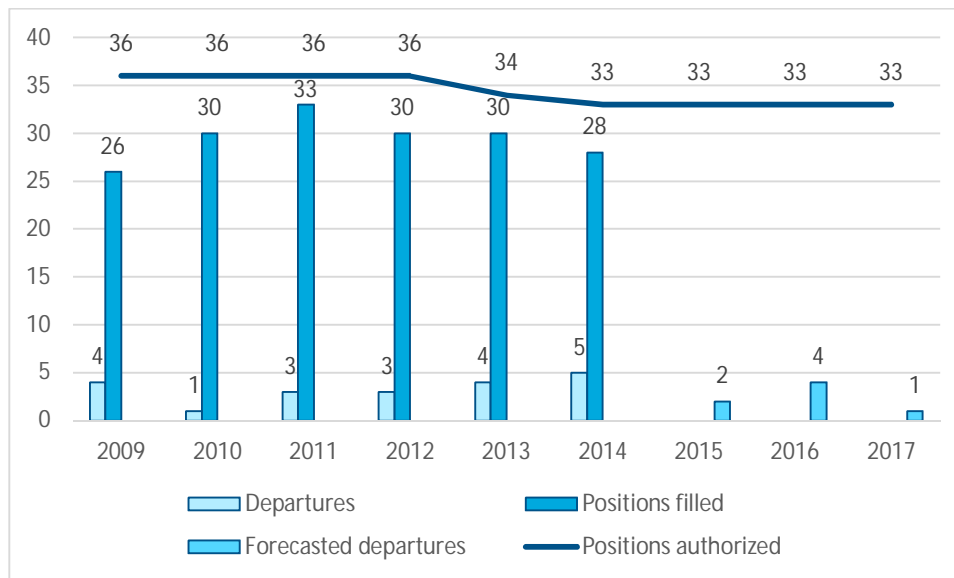
1.3. Maintaining the BVG's Expertise

My office's credibility and power of influence undoubtedly depend on the expertise demonstrated by its human resources. Given the scope of my mandate and the fact that my report is made public, my staff must have extensive knowledge of various fields in addition to their exceptional auditing skills.

To this effect, the BVG's philosophy consists on the one hand of disposing internally, to the extent possible, of a core of experienced professionals who collectively possess expertise on the City's different spheres of professional activity that are covered by my mandate: the financial audit, the resource optimization audit and regulatory compliance. On the other hand, the BVG's philosophy consists of hiring external resources to meet its ad hoc needs in terms of highly specialized expertise or to even out the workload over the peak period during which we audit the financial statements of the City and its reporting entities.

As I mentioned repeatedly in my previous annual reports, attracting and retaining competent resources is an ongoing challenge for the BVG. Moreover, the evolution and forecasting of my office's workforce from 2009 to 2017 (Figure 1) eloquently illustrate that maintaining our expertise on an ongoing basis is not an easy task.

Figure 1 – Evolution and Forecasting of BVG Workforce from 2009 to 2017



Indeed, we note that positions were vacant at the end of 2009, 2010, 2011, 2012, 2013 and 2014. Furthermore, there is reason for serious concern regarding the situation over the next three years given that:

- five positions were vacant on December 31, 2014;
- seven departures are planned, including three of the four members of the BVG's management team;
- the most recent hiring campaigns produced disappointing results—even disastrous in some cases.

Although I successfully obtained in 2009 the creation of senior professional positions, and my office examined different possibilities with the Service des ressources humaines to mitigate the risk of losing expertise, it has become obvious that these measures did not yield the expected results.

In fact, the qualified staff that my office requires is difficult to find and in high demand in the private sector and with other public entities. In this context, the fact that the overall remuneration that we are able to offer is not very competitive compared with what our reference market can offer represents a major obstacle.

This situation seriously threatens our ability to play our role as watchdog of the City's public finances on behalf of the elected officials and citizens of Montreal. Nevertheless, we must pursue our efforts in an attempt to hire employees who have the qualifications that meet our very high expectations.

I therefore intend to once again ask for the support of the Service des ressources humaines to help my office find solutions to the complex issue of maintaining the BVG's expertise. We intend to begin taking these steps in May 2015 to be able to quickly inform the municipal council of the results obtained.

1.4. Internal Control Deficiency Observed During the Audit of the Consolidated Financial Statements of the Ville de Montréal for the Year Ended December 31, 2014

During our review of the evidence obtained as part of the audit of the City's consolidated financial statements for the year ended December 31, 2014, we detected a significant misstatement involving the balances presented in the audited 2013 financial statements. The misstatement concerns a municipal property that does not comply with the *Fisheries Act* with respect to environmental protection. Considering the magnitude of the sums in question, the 2013 amounts presented for comparative purposes in the 2014 financial statements were adjusted by \$65 million to take into account the environmental liability and related expense (refer to Note 3 in the City's 2014 consolidated financial statements).

This adjustment emphasizes a deficiency of disclosure regarding the environmental liability that has been repeated in the City's financial statements since 2011. Indeed, in light of the developments in this regard, this non-compliance with the legislation (and, therefore, the creation of a contingent liability) should have been the subject of a note to the City's financial statements since 2011 to account for the liability in the City's 2013 financial statements.

It is clear from discussions with City officials that the documents disclosing the contingent liability had been available since 2011. However, they were only brought to the attention of the Service des finances in 2014. The documents required to account for the liability and the expense, on the other hand, had been available since 2013 and were only brought to the attention of the Service des finances in 2014.

Thus, the detected misstatement shed light on a flaw in the City's financial statement closing process. The channels that ensure the communication of all of the information required to prepare reliable consolidated financial statements were not effective and led to the consequences described.

This lack of internal control was the subject of a recommendation that I made to the Service des finances jointly with our co-auditor of the City's financial statements (Deloitte). In this recommendation, we asked the Service des finances to revise the financial statement closing process to obtain on a timely basis the appropriate and necessary information to ensure the reliability of the consolidated financial statements that it is responsible for preparing.

Allow me to provide a short reminder of the responsibilities of the City's management and those charged with its governance under the Canadian Auditing Standards (CASs) in the matters of preparing financial statements and of internal controls:

- *[...] management and, where appropriate, those charged with governance [...] are responsible for the preparation of the financial statements [...]; for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; (CAS 200.A2 a and b);*
- *internal control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to the reliability of financial reporting, the effectiveness and efficiency of operations, and compliance with applicable laws and regulations. [...]* (CAS 315.4 c).

I consider that management and governance responsibilities must include all necessary measures to compensate for significant risks that could jeopardize the reliability of the financial information.

Although the City uses an accounting and communication structure to prepare the consolidated financial statements, this structure has proven itself insufficient to account for this significant item in a timely manner. The circumstances surrounding the situation that led to the required adjustment of the financial statements this year were specific to this case. The City's management and those charged with its governance must revise the financial statement closing process to allow for the timely identification of all significant items that must be included in the City's financial statements.

1.5. Government Transfers

Revised Section PS 3410 of the CPA Canada Public Sector Accounting Handbook, which deals with government transfers, came into force for fiscal periods beginning April 1, 2012. In the case of the Ville de Montréal, this section applies to the City's consolidated financial statements since December 31, 2013.

There are diverging interpretations within the accounting profession as to the application of this section, namely with respect to recording multiyear instalments received from the Quebec government. Indeed, as part of its activities, the Quebec government subsidizes public and municipal entities but does not immediately pay the full amounts of the subsidies granted under the agreements reached. Instead, it requires the subsidized entities to contract loans covering the amounts granted in subsidies and commits to reimbursing the annual payments made by the entities in capital and interest on these loans. The Ville de Montréal, along with all auditors general of Quebec municipalities and the auditor general of Quebec, considers that the agreement reached with the Quebec government on the latter's reimbursement of the cost of the debt contracted by the City for specific subsidy programs allows it to record an account receivable for the full amount of the subsidy granted. However, Deloitte, the firm that co-audits the City's financial statements, does not share this reasoning. It considers that government transfers should not be recorded until the sums have been approved by the National Assembly.

The consolidated financial statements of the Ville de Montréal for the fiscal period ended December 31, 2014, were audited jointly with Deloitte. Once the work was completed, I produced an independent auditor's report with an unqualified opinion whereas Deloitte added a qualification in its report dealing with this section of the handbook.

In the case of the audit of the consolidated financial statements of the Société de transport de Montréal (STM), the opposite occurred. The STM does not record multiyear instalments as receivables. Consequently, I included a qualification in my opinion accompanying the STM's financial statements whereas Deloitte issued an unqualified opinion.

The STM, which produces its financial statements annually, is one of the City's more significant entities, and its financial information must accordingly be incorporated in the City's consolidated financial statements. The City must adjust this information to include all multiyear instalments yet to be received, resulting in an increased workload.

The difference in how the Ville de Montréal and the STM record government transfers does not exist at the provincial level. Indeed, for the other eight municipalities of 100,000 or more inhabitants whose consolidated financial statements include the results of their mass transit companies, the same accounting position is applied for both the City and its mass transit company in 2013.

It is therefore my opinion that the STM should adopt the City's way of recording multiyear instalments to be received from the Quebec government.

Another important current fact must be pointed out. On April 14, 2015, CPA Quebec posted on its website a summary of a meeting held on April 8, 2015, between several representatives of the professional order's different working groups and Mr. Tim Beauchamp, CPA, CMA (Ontario), Director of the Public Sector Accounting Board (PSAB). During this meeting, Mr. Beauchamp mentioned that [TRANSLATION] [...] *the need for an appropriation or equivalent authority to issue a cheque is not the key consideration as to whether a liability (or a receivable for the recipient) should be recorded [...]*. Moreover, he stressed that the professional judgement is always paramount, namely in the case at hand. Discussions are still underway in this regard.

Recommendation

I recommend that the Direction générale take action along with the director of the Service des finances to have the STM adopt the City's way of recording government transfers.

1.6. Audit of the Financial Statements of Technoparc Montréal

I audited the non-consolidated financial statements of Technoparc Montréal for the year ended December 31, 2014. Following this work, I had planned to issue an independent auditor's report containing a qualification concerning the fact that Technoparc Montréal had not consolidated information concerning Fiducie du Technoparc Montréal in its financial statements. It is nevertheless required to do so under Section PS 2500 ("Basic Principles of Consolidation") of the CPA Canada Public Sector Accounting Handbook.

Since December 31, 2012, my opinion issued on the financial statements of Technoparc Montréal has also included a qualification on a debt in the amount of \$1,543,000. This qualification was deemed necessary because the Ville de Montréal had been recording this amount in its ledgers for several years as an amount receivable from Technoparc Montréal. The City had also recorded an estimated liability in the same amount.

During the finalization of the audit of the financial statements for the year ended December 31, 2014, the confirmation received from the City did not mention the existence of this debt. Despite that, with the aim of avoiding the qualification in the auditor general's opinion, the management of Technoparc Montréal decided to account for the debt in its financial statements. However, it was unable to provide sufficient and convincing evidence enabling me to reach a conclusion on the substance of the transaction to determine whether the recognition of a debt would be justified and to identify the other items that could be impacted in return. Several exchanges were needed between management and my office's representatives in this regard. In April 2015, management finally decided to reverse the entry of this debt.

The fact that management reversed its decision to record the debt confirms that Technoparc Montréal does not currently dispose of sufficient and necessary evidence to justify recording this debt in its financial statements. Consequently, I intend to remove the qualification on this debt from my independent auditor's report on the financial statements of Technoparc Montréal for the year ended December 31, 2014.

I recommended to the management of Technoparc Montréal that it take measures to ensure that its financial statement closing process is based on sufficient and appropriate evidence before entering a transaction in its ledgers, in accordance with the Canadian public sector accounting standards.