MINISTRY OF THE ATTORNEY GENERAL

3.01–Office of the Public Guardian and Trustee

VFM Section 3.01

BACKGROUND

The Office of the Public Guardian and Trustee (Office) operates under the *Public Guardian and Trustee Act* and various other provincial statutes. Its primary responsibilities include providing services to mentally incapable persons by:

- acting as the guardian of property and/or personal care for mentally incompetent individuals; and
- acting as the treatment decision-maker of last resort for persons who are not capable of making their own decisions and who have no one else to make these decisions for them.

Other primary responsibilities of the Office include:

- the administration of estates of persons who die in Ontario without a will and without known relatives;
- gathering assets on behalf of the Crown when there is no known owner of these assets or the owner is a corporation no longer in existence; and
- a general supervisory role over charities and charitable properties to protect the public's interest.

Since 1997, the duties of the Office have expanded to include those of the Accountant of the Superior Court of Justice (then the Accountant of the Ontario Court), which is the depository for all monies, mortgages, and securities paid into, or lodged with, the court. These assets are received and disbursed pursuant to judgments and orders of the court. The Accountant of the Superior Court of Justice also administers monies received by the court to the credit of minors until they reach the age of majority.

The Office charges fees for its services to incapable clients and for administering estates. Service fees vary in accordance with amounts permitted by legislation based on the value of assets, income, and services required. Total service fees collected in the year ended March 31, 2004 amounted to approximately $16.5 million. For the fiscal year ended March 31, 2004, the Office was responsible for the investment and management of approximately $1 billion of assets as trustee for its incapable and other clients from the various programs.

The Office's head office is located in Toronto, with regional offices in Toronto, Hamilton, London, Ottawa, and Sudbury. For the fiscal year ended March 31, 2004, the Office had approximately 300 staff and operating expenditures of $27 million.

AUDIT OBJECTIVES AND SCOPE

Our audit objectives were to assess whether the Office had adequate systems and procedures in place to:

- fulfill its key mandates, including: protecting the rights and interests of mentally incapable clients, administering the estates of deceased persons without a will or known next of kin in Ontario, and protecting the public's interest in charities; and
- ensure its services and programs were delivered economically and efficiently.

Our audit focused on the core programs and activities of the Office: Services to Incapable Persons, Estate Administration, the Accountant of the Superior Court of Justice, the Charitable Properties Program, and the investment of trust assets. At the beginning of our audit, we identified audit criteria that would be used to address our audit objectives. These were reviewed and accepted in November 2003 by senior management of the Office.

The scope of our audit, which was substantially completed in March 2004, included interviews, inquiries, and discussions with relevant staff of the Office, as well as reviews of client files, the Office's policies and procedures, and relevant management and external consultants' reports. We also reviewed and took into consideration the work performed by the Ministry's and the Office's internal audit staff in determining the extent of our audit work.

Our audit was performed in accordance with the standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

OVERALL AUDIT CONCLUSIONS

We concluded that the Office had made a number of key operational improvements since our last audit in 1999. Specifically:

- Authority to provide guardianship services was being obtained on a more timely basis.

- In providing services to incapable clients, the Office was generally meeting performance targets relating to the frequency of visits, the protection of the legal interests of incapable clients, and the securing and disposing of assets.
- Close-out procedures in transferring assets to a client's estate were being performed satisfactorily.
- Decisions regarding medical treatment were supported by medical and other required documentation.

While improvements have been made over the last five years in the Office's ability to fulfill its mandate, our current audit did identify areas where improvements were still required. Specifically:

- In the administration of estates, while some progress has been made in locating heirs for estates taken over, a significant backlog still exists.
- Although initial action had been taken to locate all minors who are entitled to assets being held by the Accountant of the Superior Court of Justice once they have become eligible for payment, in a number of cases there was a lack of follow-up action.

In addition, with respect to the management of the $1 billion in assets entrusted to the Office for investment under its various programs, we noted the following:

- In selecting fund managers, one candidate was selected as top choice to manage the diversified and Canadian money market funds ($50 million and $300 million, respectively), despite the fact that this candidate had consistently underperformed when compared to the performance of most of the other candidates and to market benchmarks for 10 years prior to its selection. We were also concerned that after being awarded the contract for the Canadian money market fund, the successful candidate was granted substantially higher management fees than its original quote, even though this candidate had been awarded the contract primarily because of its low fees quote.
- The Office did not adequately assess the suitability of incapable clients with respect to their health and age before investing their funds in higher-risk stock markets through its diversified equities fund rather than in fixed-income funds.
- Insufficient attention was paid to ensuring appropriate diversity of client investment portfolios. This resulted in some clients incurring significant losses. For instance, 80% of one elderly client's assets were in one stock, which, as a result of a subsequent significant decrease in the value of this one stock, resulted in an over 80% decline in portfolio value over a three-and-a-half-year period.

Our current audit also concluded that the Office had adequate procedures for reviewing applications for incorporating charities and to handle complaints. However, it had not adequately followed up on charities deregistered by the Canada Revenue

Agency to ensure that their assets were properly distributed to beneficiaries or transferred to successor charities to prevent misuse or misappropriation.

DETAILED AUDIT OBSERVATIONS

SERVICES TO INCAPABLE PERSONS

With the exception of about 20 personal-care guardianships, almost all of the Office's 9,000 cases of incapable clients involve property guardianship, which requires the Office to manage these clients' financial affairs. Since these clients have no one willing and able to make decisions for them, guardianship is necessary to protect them from potential harm caused by abuse and/or neglect. Approximately 30% of these clients reside in nursing homes or other chronic-care institutions. The rest reside in the community in non-institutional residences. Guardianship involves ensuring that clients receive all the income and/or benefits they are entitled to, determining their spending allowances and expense requirements, and setting up routine payments to meet those requirements.

For about 12% of clients with real estate or other substantial assets, Office staff are required to identify and account for all client assets on a timely basis, arrange for routine property maintenance and annual inspections, and dispose of assets when appropriate to reduce the risk of clients losing the value of their assets and avoid unnecessary maintenance and other expenses.

Our review of guardianship cases indicated that, except for the investment of the assets (see the section on "Investment of Trust Assets" for a discussion of investing clients' funds), the Office had improved its services to its incapable clients. Specifically, we noted:

- The Office had obtained authority to provide guardianship services to clients on a timely basis and in compliance with legislative and Office requirements.
- The Office had established and generally met performance targets relating to frequency of visits, the timeliness of taking legal actions to protect the interest of incapable clients, field investigation of property, redirection of income, and securing and disposing of assets.
- The Office's authority as guardian for incapable persons is terminated upon the death of the client, by the client regaining capability, or by the loss of continuing jurisdiction to manage the client's affairs. We were satisfied that closing-out procedures were performed in an appropriate and timely manner in transferring assets to the client's estate, to the client if the client has been found capable, or to a private guardian.

In addition to providing guardianship services, the Office also decided on treatment for individuals who had no relative or legally designated decision-maker willing and able to make such decisions. We noted that such decisions were supported by medical and other documentation.

ESTATE ADMINISTRATION

The Office is responsible for administering the estates of individuals who die in Ontario without a will or known next of kin, providing the estate has a value of at least $5,000. For the estates it is administering, the Office conducts investigations to determine if the deceased had a will, applies to court for the estate administration, identifies and locates heirs up to second cousins where possible, and distributes assets to beneficiaries. For its efforts, the Office is compensated based on a percentage of the assets as allowed by provincial law for trust administration. Under the *Escheats Act*, if heirs cannot be located, the assets of an estate become payable to the province 10 years after the date of death.

As of December 2003, the Office had 1,785 outstanding estate files with assets valued at about $87 million under its administration as shown in the following table.

Estates under Administration as of December 2003

Estates under Administration	Number	Value
files opened prior to 1993 (payable to the province)	460	$18,000,000
files opened from 1993 to 1998	564	$21,000,000
files opened from 1999 to 2003	761	$49,000,000
Total	**1,785**	**$87,000,000**

Source of data: Office of the Public Guardian and Trustee

Locating Heirs

In our 1999 audit of estate administration, we were concerned with the lack of timely searches for the heirs of estates taken over prior to 1996. Subsequent to our audit, a special project was initiated in October 1999 to review 547 files with assets valued at more than $10,000. As a result of this special project and the more timely efforts of staff in processing current files, we noted that the Office has improved its effectiveness in locating heirs on a more timely basis. However, our review of the files from the 1999 special project showed that in a number of cases, even though heirs had been located more than two years ago, follow-up letters advising the heirs of their entitlements were not sent out until we inquired about those cases. The Office indicated that staff turnover was the main reason for the lack of timeliness in advising the heirs.

Once heirs are located and proof of heirship established, an estate file is classified as under interim closure until assets are distributed. The file is closed only when all the assets are distributed. Our review indicated that there had been a steady increase in the number of files closed and amount distributed since our 1999 audit. However, since 1999, the Office on average opened about 240 new files each year and closed 300. Although this allowed the Office to keep up with the current workload, it cleared only about 60 additional files a year. As shown in the preceding table, in December 2003 the Office still had almost 1,800 estates where either the heir needed to be located or the heir's funds needed to be distributed. The Office indicated that a number of these files—for example, those delayed by external restrictions (such as the failure of heirs to submit requested documentation or legal complications in the liquidation/administration of assets)—should not be considered as part of the backlog.

Notwithstanding, given the current rate of processing, the majority of these outstanding files would take many years to clear. This is all the more serious given that the deceased person's assets become the property of the Crown if the heirs are not located and assets are not distributed within 10 years after the deceased person's death. Although the transfers are subject to future claims of heirs, such claims are rare and infrequent, because potential heirs would have limited or no knowledge about these transfers.

Recommendation

To properly discharge its duty as estate trustees, the Office should increase its efforts to locate heirs and distribute assets on a more timely basis.

Office Response

The Office will continue to increase its efforts to conduct heir searches and distribute estate assets on a more timely basis. Considerable work has already been completed in that regard.

As of August 18, 2004, over 400 cases are ready to be finalized, subject only to a pre-closure review. An additional 219—representing most of the remaining special project files—are in the final stages of administration. Ongoing current work is being processed at an appropriate pace.

We wish to note that the Office, by policy, does not transfer any estate over $10,000 to the Crown without having first conducted a thorough search for potential heirs, even if the complexities of the case require that the search extend beyond the 10-year period.

Accountant of the Superior Court of Justice

The Accountant of the Superior Court of Justice is the depository for all monies, mortgages, and securities paid into, or lodged with, the court. In this capacity, the

Office acts not as a guardian, but rather as a custodian, and invests funds for clients. These funds are received and released pursuant to judgments and orders of the court, and in accordance with the *Courts of Justice Act* and other relevant statutes. Where monies are paid into court to the credit of minors, the Office is to administer the funds until the children reach the age of majority (18) or as specified by the court.

As of November 2003, the Accountant had approximately $501 million in assets under its administration. Of this amount, $341 million was from about 25,500 minor accounts and $160 million was from approximately 12,500 litigant accounts.

Distribution of Assets

In our 1999 audit, we noted that a significant number of assets intended for the benefit of children had not been distributed until years after the individuals had reached the age of majority at 18. Following that audit, the Office initiated a special project in February 2000 to clear the backlog. The project was successful in paying out about 85% of the assets identified as being overdue in our audit. As of March 2004, there were still more than 600 of the former minors with about $4.6 million in assets that had yet to be paid. About 270 of these minors, with assets totalling $2 million, were over 25 years of age.

Our current audit indicated that since 2000 the initial notifications to minors to inform them of their entitlement were generally sent out on a timely basis. However, after the notices were sent out, there was a lack of follow-up, such as through Ministry of Transportation drivers' licence records, to search for these minors where the current address was unknown. We noted that in a number of cases there had been no follow-up for two to three years after the initial notification letter had been sent out.

Recommendation

To ensure that beneficiaries receive funds when they are legally entitled to them, the Office should initiate more rigorous and timely follow-up action to locate and distribute funds to intended beneficiaries.

Office Response

The Office agrees that follow-up action must be timely and took steps to ensure that this would be the case by putting in place a new tracking system in December 2003 that would monitor responses and provide reminders to staff. All accounts have now been followed up and will continue to be rigorously monitored.

INVESTMENT OF TRUST ASSETS

The Office acts as a trustee to manage and invest trust assets from all its programs in order to earn a reasonable rate of return while also maintaining the original principal and investments; in total, the Office administers about $1 billion in trust assets. In the past, the Office invested trust assets in accordance with a list of investment instruments authorized by section 3 of the *Financial Administration Act* and sections 26 and 27 of the *Trustee Act.* This legislation did not allow a trustee to invest trust funds in investment instruments other than fixed income securities. As a result of legislative changes, the *Trustee Act* was amended in July 1999 to require the use of a "prudent investor standard" and stipulated that a trustee:

- must exercise the care, skill, diligence, and judgment that a prudent investor would exercise in making investments;
- may invest trust property in any form of property (including stocks) in which a prudent investor might invest; and
- must diversify the investment of trust property to the extent appropriate.

Recognizing the diverse objectives of its client base, the Office established the following investment vehicles to invest clients' assets:

- The **diversified fund** (over $100 million under management) consists of a portfolio of Canadian and foreign stocks and bonds designed to generate capital gains and a stable income yield. To participate in the diversified fund, a client's assets must be able to be held for five years or more; the client must not require access to the capital in the near future and must need to preserve and enhance the purchasing power of his or her capital over the longer term.
- The **fixed income fund** (over $800 million under management) combines the yields from two money market funds and a bond fund. All trust property and clients' funds not invested in the diversified fund are invested in the fixed income fund.

To select investment management firms for these funds, the Office engaged an external adviser to assist in evaluating the firms and negotiating with them.

Engagement of Investment Advisory Firm

Since 1992, the Office has engaged the service of the same investment advisory firm to provide continuous general advice relating to the investment of funds. The advice is to help the Office meet its investment objectives and includes recommendations on asset mix, investment policies, and strategies. The firm also provides advice on and assists in the evaluation and selection of the investment managers responsible for the investment of the Office's funds.

The Management Board of Cabinet directive on consulting services stipulates that vendors must not be permitted to gain a monopoly for a particular kind of work, and that relationships that result in continuous reliance on a particular vendor must not be created. To enable all vendors to have a fair opportunity to compete for contracts, the directive also stipulates that sufficient lead time (a minimum of 15 days) be given to potential vendors to develop proposals and submit bids.

A contract was most recently granted to the investment advisory firm in December 2002 at a cost of approximately $225,000 over two years. The contract was awarded through a request for proposals (RFP) posted on MERX, an electronic tendering system used in the Canadian public sector. Despite there being many firms qualified to offer investment advisory services, the Office received only two bids besides that of the incumbent firm. In evaluating the three proposals, the Office awarded scores to the two competitors that, even when combined, were lower than the score of the incumbent firm.

Our audit showed that potential vendors were given only 14 days to develop a proposal and submit a bid. In addition, four of those days fell within a period of religious holidays when many staff of potential vendors would not be working, thus restricting the opportunity for some firms to compete for the contract. Moreover, the incumbent firm had the advantage of needing less time to formulate a proposal due to its long-term familiarity with the Office.

With respect to the selection of the incumbent firm, our audit found that while the incumbent investment advisory firm was registered with the Ontario Securities Commission as an investment counsel prior to 1998, its registration lapsed in March 1998 and the firm has not been registered since. Firms involved in providing investment advisory services in Canada are usually registered as investment counsel with the provincial securities commissions in the provinces where they offer their services. The Office indicated that the firm's position was that such registration was not required because continuous advice on the investment of funds was not being provided. However, aside from the fact that the Office had indicated that it did engage the firm to provide continuous general advice on the investment of funds, the purpose of registration is to ensure that firms are qualified to provide investment advisory services and that they comply with specific filing and disclosure requirements.

As the same investment advisory firm has been used since 1992, we are concerned that a situation of monopoly and a situation of continuous reliance could develop in the Office's relationship with this firm. We encourage the Office to ensure that all vendors are provided with a fair opportunity to compete for this contract.

Recommendation

To obtain better value and to avoid continuous reliance on a particular vendor, the Office should establish appropriate mechanisms for attracting more potential vendors for the provision of investment advisory services.

Office Response

The Office acknowledges that, although its 2002 request for proposals (RFP) for investment consulting services was posted on MERX to permit fair and open access, the posting was for 14 days as opposed to the 15 days required by Management Board policy. The Office will ensure that future RFPs more fully comply with Management Board policy and will explore ways to attract more potential vendors.

Selection of Diversified Fund Managers

The Office posted an RFP in early 2000 on MERX to select two investment management firms to manage the diversified fund. The use of two investment managers diversifies the risks that might occur with just one manager investing in the market. The candidates were required to submit their performance records relating to Canadian stocks, foreign stocks, and bonds for the previous 10 years. With the assistance of the investment advisory firm, the Office developed a total-performance benchmark to evaluate the candidates, consisting of a mix of market indexes to reflect the Canadian, global, and bond markets. We were advised that the investment advisory firm applied additional qualitative criteria, including investment philosophy and style, risk controls, succession planning, and records of staff turnover, client service, experience, and firm reputation to determine the short list. Proposals were received from 15 firms, and five firms were shortlisted and interviewed. Numerical scores were used to rank the candidates, and the managers with the highest and second-highest scores were selected to manage the diversified fund.

SELECTION PROCESS

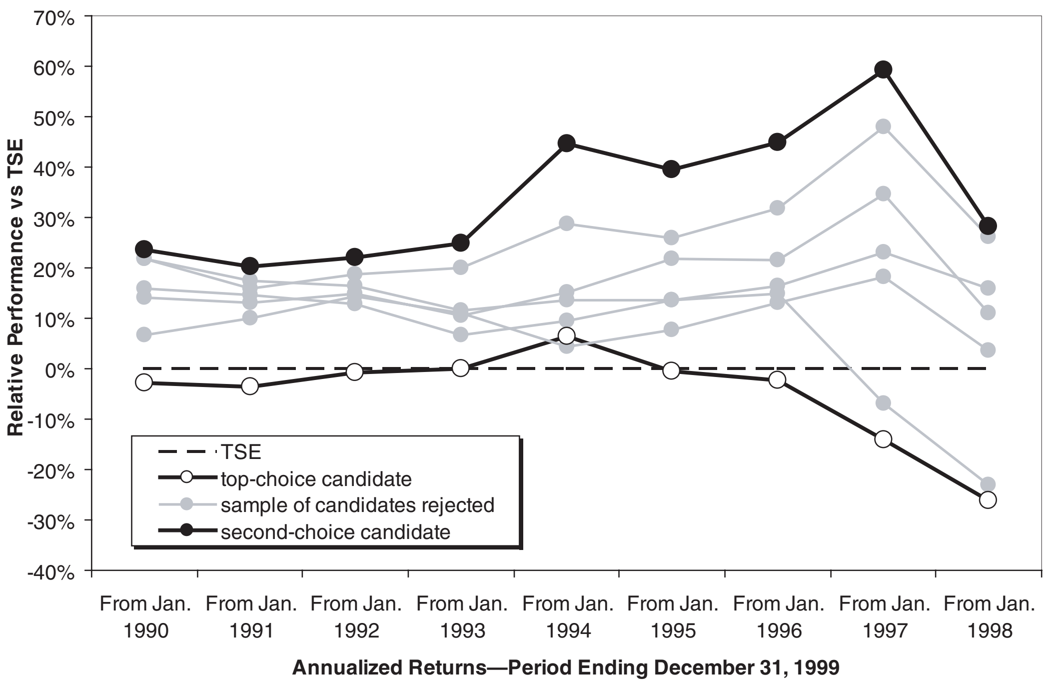
Two candidate firms were selected and we noted that the candidate with the second-highest scores consistently met the performance benchmark selection criteria established by the Office. However, the candidate that the Office selected as its top choice did not. In fact, the top-choice candidate consistently had the lowest annualized investment performance of all the shortlisted candidates. Management responded that investment performance was important in evaluating candidates, but that:

- Performance was the key factor only at the first stage of selection. Management informed us that a screening of all 15 candidates had already been done to eliminate consistent underperformers. Consequently, performance was no longer an important factor in ranking shortlisted candidates.

- The screening results indicated that the differences in past performance among the shortlisted candidates were not significant.

However, when we compared the past performance of all candidates, we noted that the top-choice candidate was shortlisted despite the fact that it had underperformed with respect to the total-performance benchmark established by the Office and to other candidates. Its performance in terms of annualized returns over the years was the lowest of the shortlisted candidates and was 13th out of all 15 candidates. With respect to the performance of this candidate in Canadian equities, the following chart compares its performance relative to the TSE 300 Index and a sample of top candidates over the 10 years prior to its selection.

A Comparison of Market Performance for Diversified Fund Candidates



Source of data: Office of the Public Guardian and Trustee

As the line graph illustrates, the manager selected by the Office as its top choice outperformed the TSE 300 Index only once in the 10-year period on an annualized-return basis.

The candidate also consistently underperformed in relation to the benchmark for the global equity market. Its performance met the benchmark in the bond market. However, overall it had not met the total-performance benchmark on an annualized-return basis in the eight years prior to its selection.

We noted that, in reporting the screening results, the Office itself pointed to studies stating that past top-quartile managers have a statistically significant probability of outperforming in subsequent periods and that managers who underperform have a stronger likelihood of underperforming in the future. In this regard, our review of the relative performance of the two selected managers for their annualized returns of Canadian stocks showed that the second-choice manager provided better returns than the top-choice manager by—depending on the year of initial investment—22% to 85% in the 10 years prior to being selected in 2000. We found the screening process questionable, since it appropriately highlighted the importance of past investment performance but did not clearly identify that this candidate had consistently underperformed.

Post-selection Performance—Diversified Fund

The two managers were each given over $50 million to invest to allow for ready comparison of post-selection performance. From August 2000 through March 2004, both managers met the Office's expectation that they meet or exceed a benchmark performance of various stock and land indexes.

However, the top-choice manager's return was $10 million lower than the return earned by the second-choice manager. Over the three-and-a-half-year period, the second-choice manager attained a return of 7.1%, whereas the top-choice manager's return was only 1.7% per year.

Individual clients who had funds invested in the diversified fund would have their funds spread equally between the two managers. In addition, only a portion of these clients' assets would be invested in the diversified fund, with the remaining portion invested in the Office's regular fixed-income interest account. To put this in perspective, a client with a $100,000 investment in the diversified fund over the three and a half years would have had an actual return of $16,000 (4.4%) per year ($13,000 return from the second-choice manager and $3,000 from the top-choice manager). The portion of funds not invested in the diversified fund would have provided a return of 5.5% per year from the Office's regular fixed-interest account.

Recommendation

The Office should critically evaluate the performance of potential investment managers based on investment returns and ensure that its process for selection of investment managers eliminates candidates that consistently underperform.

Office Response

The two managers that were selected have different investment styles, such that one can be expected to perform better than the other in certain market conditions. Choosing managers with a variation in styles was a method of addressing the risk that is posed by unpredictable market conditions. One manager's style produced good results during a period when the stock market was volatile, while the other manager's style has produced higher returns in the past year under different market conditions.

The Office agrees that evaluation of performance of potential investment managers is an important step in the selection of a fund manager and will ensure that, in the future, the past performance of potential investment managers will be more critically evaluated in the selection of investment managers.

Selection of Fixed Income Funds' Managers

With over $800 million under management, the fixed income funds primarily comprise two money market funds and a bond fund.

- The two money market funds consist of a small U.S. fund with about $4 million (mainly for clients with U.S. funds) and a Canadian fund with about $320 million in assets as of December 31, 2003. Both funds include fixed income short-term government treasury bills and corporate paper; they are designed to preserve original capital and to generate income.
- The bond fund includes bonds designed to generate a high, stable income yield and to preserve original capital. The fund is managed using a "laddered buy-and-hold" (LBH) strategy, whereby individual fixed income securities with different maturity intervals are purchased and held to maturity. As of December 31, 2003, the LBH bond fund had assets of about $515 million.

TENDERING PROCESS

To achieve the best value and to promote fair dealings and equitable relationships with the private sector, the Management Board of Cabinet directive for the procurement of goods and services stipulates specific competition requirements. Specifically, the directive states that services with an estimated total contract value of over $100,000 must be acquired through an open tendering process. The reasons for any exceptions to open tendering must be justifiable and properly documented, and prior approval must be obtained from the deputy head or his or her designate.

We noted that in contrast to the process for the smaller diversified fund of just over $100 million, which was an open tender, the RFP issued in early 2002 for the management of the over $800 million fixed income funds that had expected total contract values of over $500,000 for three years, was not acquired through a call for open tender. Instead, the Office invited tender from only the four existing investment managers who were already administering the diversified fund and the fixed income funds. There was also no evidence of prior approval from the Deputy Attorney General and no documentation had been kept on the justification for not following the open-tendering requirement.

In response to our inquiry, the Office indicated that it did not consider it necessary to open the field to other potential candidates because the current managers were all performing adequately, and they had all been previously acquired through a formal tendering process and already understood the Office's mandate and investment objectives. However, given the significant size of the assets being managed under the fixed income fund, we were concerned that the competition was not extended to a wider range of potential candidates to ensure best value for the funds expended and that the competition was not a fully open and transparent process.

SELECTION OF MONEY MARKET FUNDS' MANAGER

In response to the RFP, three investment management firms, including the incumbent, submitted proposals to manage the Canadian money market fund with assets over $300 million; one firm declined the invitation. We noted that the top-choice candidate selected for the diversified fund was also selected to manage the money market fund. The Office indicated that the selection was mainly based on management fees because differences in performance were not significant. It also indicated that all three potential managers exhibited the same performance on an annualized five-year basis. However, our review of the performance comparison report used by the Office to select the fund manager showed that as of March 31, 2002, on an annualized basis the selected candidate's performance was the lowest of all candidates in seven of the prior 10 years.

We noted that the selected candidate had offered a very attractive fee quote of 2.2 basis points (bp)—a basis point is one-hundredth of a percentage point. The incumbent manager's fee was 5 bp, but the incumbent manager had a better performance record during its contract. In most of the prior 10 years, the incumbent manager earned 20 bp more in annualized returns than did the successful candidate.

After subtracting the higher fee difference of 2.8 bp from the 20 bp in extra returns, the net return from the incumbent manager would have been an extra 17.8 bp in annualized returns. To put this in perspective, an extra 17.8 bp on a $300 million fund could yield an additional return of over $500,000 per year to the Office's clients.

As the Office considered the fee quote to be the primary criterion as opposed to investment performance, the Office requested both managers to resubmit a fee quote. Neither fund manager changed its quote and the candidate with the lower fee was awarded the contract. However, we noted that subsequent to being awarded the contract, the selected candidate was granted a higher fee than its original quote. The Office advised us that the firm advised them that it had made an error in its original fee quote of 2.2 bp. The "correct" fee should have been around 4.5 bp. The Office decided to pay a compromise fee of 3.3 bp for two years and 4.5 bp after that. The Office indicated that the decision was made based on the fact that the bidder had erred in its fee quotation. We found the decision of the Office to pay higher fees questionable because:

- The selected firm had been given an opportunity to resubmit its quote and instead confirmed that it would stand by its original quote.

- The sole reason the firm was given the contract was due to its fee of 2.2 bp, as its performance was clearly below that of the incumbent manager.

Post-selection Performance—Fixed Income Funds

Unlike the smaller diversified fund, where two fund managers were used in order to compare post-selection performance, the $800 million fixed income funds were not designed to have two managers for comparison and monitoring purposes.

For the money market fund, the Office indicated that the newly selected investment management firm had performed well based on a benchmark established to measure its performance. However, our review showed that this benchmark was based on the Scotia Capital 91-day T-bill Index. An index such as this is used to measure performance for investment in relatively risk-free treasury bills issued by the federal and provincial governments. Our examination of the investments made by the fund manager for the final quarter of the 2003/04 fiscal year found that about half the fund was invested in higher-risk corporate paper issued by the private sector. Since corporate money market investments carry a higher risk and accordingly yield a higher return than government T-bills, the government T-bill index was not an appropriate performance benchmark.

Our review of the Office's money market fund for the 2003/04 fiscal year noted that, despite half of the funds being invested in higher-yielding corporate paper, its performance was only 0.01% above the Scotia Capital 91-day T-bill Index, before investment management fees.

With respect to the bond fund, the Office had not established any benchmark to measure the performance of the fund. The Office indicated that it did not establish a performance benchmark because the bonds were intended to be held to maturity. In addition, the bonds being held in the funds were laddered with different maturity dates. Accordingly, the Office had not yet been able to identify appropriate performance indicators.

However, without appropriate performance indicators, the prudence of the decision to hold bonds to maturity cannot be determined. Performance factors also need to be taken into account when making future investment decisions. We therefore maintain that it would be beneficial to compare the actual performance of this fund against appropriate performance benchmarks accepted by the industry.

Recommendation

To enhance returns for its clients, when selecting money market investment managers the Office should:

- **use an open, competitive tender process, such as posting requests for proposals for all significant contracts on the public electronic tendering system; and**
- **evaluate candidates based on a combination of performance and fees.**

In addition, the Office should not pay fees higher than those agreed to when the contract was awarded.

Furthermore, the Office should establish appropriate indicators to measure the performance of its fund managers against appropriate investment benchmarks.

Office Response

The Office agrees with the Provincial Auditor as to the importance of achieving best value and promoting fair dealings and equitable relationships with the private sector. An open, competitive tender process is a key element in this, and the Office will ensure this occurs in the future.

As the report notes, the selected manager was subsequently permitted to raise its fees, but the fees were still lower than those of the other managers. The Office accepts the recommendation in the report that this fee adjustment should have been refused.

The benchmark selected by the Office for the money market fund is standard in the industry. A poll of six of the largest money market managers in the country, representing $20 billion of money market assets, disclosed that five managers consistently used this index, and one manager used one that was even lower.

No benchmark is in place for the bond fund because of its unique and simple structure. Investments are held to maturity. There are no suitable benchmarks. However, the bond fund manager is monitored to ensure that its actions are appropriate. Returns on the Office's bond fund have consistently exceeded returns earned on other types of fixed income instruments, such as guaranteed investment certificates and treasury bills.

The Office agrees that it is very important to have in place suitable benchmarks and metrics and will undertake to review and update them regularly.

Investing in the Diversified Fund for Individual Clients

Most clients of the Office do not have significant assets and do not qualify for investing in the diversified fund because of their cash requirements. Accordingly, any funds available for these individuals are deposited in the Office's fixed income funds to generate steady interest income.

Clients who have a significant amount of money that is not required for daily living and that will not be needed for at least five years are assessed for investing in the diversified fund. Before a client's funds can be invested in this higher-risk fund, a financial review has to be completed. The process requires that the financial review be prepared by a financial planner with input from a caseworker who is familiar with the client's circumstances. The resulting financial review has to be provided to both the caseworker and the caseworker's team leader to review the accuracy of the information and to approve the investment recommendations.

REVIEW AND APPROVAL PROCESS TO SELECT CLIENTS FOR INVESTMENT

To assess whether only eligible clients were selected for the participation in the diversified fund, we reviewed the financial planning process performed by the Office. We requested that the Office provide us with the files of all clients who had at least $200,000 invested in the diversified fund from its inception in August 2000 until December 31, 2003. According to the Office, there were 50 incapable clients and 20 minors who had invested at least $200,000 in the fund. The Office had invested a total of $26 million on behalf of these clients in the diversified fund.

We noted evidence to support only three cases where financial plans of incapable clients had been provided to caseworkers for review. In only one of those cases were we able to see approval of the investment recommendations in the diversified fund by a team leader. Although the Office reminded staff by e-mail in late July 2000 to review, sign, and return the financial plans in physical form, we were informed that the staff were unclear as to what was required and were reluctant to submit written comments.

The Office indicated that procedures to require formal documented approval were not implemented until November 2000, although most of the clients' investments in the diversified fund were made in August 2000. Consequently, formal documentation of consultation on these earlier files was incomplete. As of March 2004, however, our audit indicated that no follow-up documentation of consultation on these files had been done.

We are concerned that without the proper input from individuals familiar with the circumstances of the clients and the approval of responsible team leaders, the investment plans might not be suitable for the clients.

Recommendation

To ensure major investment decisions made for individual clients are appropriate and prudent, a proper process of consultation, review, and approval should be followed.

Office Response

The Office agrees with this recommendation and is now ensuring that files are properly documented after the consultation and review process has been concluded.

SUITABILITY OF INVESTING IN THE DIVERSIFIED FUND

For Incapable Clients

To comply with the guidelines that a client's assets must be likely to be held for five years or more and that the client must be unlikely to require access to the capital in the near future, the Office is required to properly assess the suitability of clients with respect to their health and age before assets can be invested in the diversified fund.

We reviewed the health and age assessments performed by the Office on the 50 incapable clients who had been selected to invest in the diversified fund. Our review showed that many of these clients were over 80 years old. However, most of the assessments were based on assumptions of good health and, according to the Office, on Canadian life-expectancy statistics that state "a person aged 90 can expect to live five more years; a person aged 85 can expect to live six more years, and a person aged 80 can expect to live nine more years."

It is inappropriate to make investment decisions for individual clients based only on such general assumptions of life-expectancy statistics. A more acceptable and prudent approach would be to carefully assess the health of incapable clients on an individual basis. In fact, our review of these 50 clients noted that almost half of them died within three years of their funds being invested. The average age of the clients who died was 82, and their average age was 80 at the time their initial investments were made.

For Minor Clients of the Accountant of the Superior Court

The 1999 guidelines require that a client's assets must be available to be held for five years or more and that the client must not require access to the capital in the near future; therefore, the Office stipulates that deposits in the court for minors can be invested in the diversified fund only for children 12 years of age or younger. This is because clients are generally entitled to their funds once they reach 18 years of age. Because minors often become clients as a result of serious injuries from accidents and have significant health problems, the Office requires an assessment of their health before their funds are invested in the diversified fund.

Our review of the 20 minors who had at least $200,000 invested in the diversified fund noted a number of instances where the Office's investment guidelines were not followed:

- Sixteen of the 20 clients did not have the required health assessment or their status was assessed as "unknown."
- Nine (45%) of the 20 clients were not 12 years of age or younger at the time their funds were invested and three of them were 15 years or older.
- Under the "Special Consideration" section of the assessment form, Office staff were instructed to obtain relevant information (for example, a related adult's views) for the financial review. We noted that no parents or guardians were consulted to obtain relevant information regarding the situation of their children.

The Office indicated that the Office of the Children's Lawyer had been contacted for relevant information concerning the children. However, we noted that in response to the information request for investment purposes, the Children's Lawyer stated, "I am questioning whether we're adding value to the process. There are many minors with money in court where we have had no involvement at all. Where we have a file for the minor, we don't often know anything about the minor and the family beyond what you can already tell from the account history, for example, if regular child support was being paid out."

Recommendation

To minimize the risk of financial losses to clients because of short-term market fluctuations, the Office should improve its review, oversight, and approval processes and ensure that its current investment guidelines are being adhered to.

Office Response

With respect to incapable adults, the Office conducts a review of each client's health status before developing a financial plan for the client's investments. Life-expectancy data are used only as guidelines for assessing age as a risk factor. However, the Office agrees that its process for assessing and documenting health status requires improvement and is taking steps to ensure that this takes place.

With respect to clients who are minors, since 2003 the Office has communicated with parents/guardians about how their children's funds are invested. When considering investments in the diversified fund, the Office advises parents/guardians and requests any relevant information, including information on health issues and financial needs.

ASSET ALLOCATION

To comply with the *Trustee Act* as amended in July 1999, a trustee must diversify the investment of trust property. According to the Investment Fund Institute of Canada

(IFIC), "not putting all one's eggs in one basket" is the key to successful investing. The IFIC advises potential investors that prudent investment strategies should include allocating assets among cash, fixed income investments, and stocks.

As investors grow older, the IFIC recommends that the fixed income portion of their investments in relation to stocks be increased. The rule of thumb is to invest 100% minus their age in stocks: for example, a 70-year-old should have no more than 30% of his or her investments in stocks. In addition, investors should adjust their asset mix according to their individual risk tolerance. Proper asset allocation allows investors to optimize returns and minimize the risk of losses due to fluctuations in the stock markets. It is more important for senior investors because of their advanced age—by and large, they have a shorter investment time-horizon to recover from a downturn in the stock market.

The Office has a policy in place requiring its staff to periodically review clients' assets to ensure appropriate allocation. However, the Office in general did not appropriately diversify and allocate assets of clients in a manner similar to the IFIC rule-of-thumb guidelines. For example, for the 22 clients we reported on earlier who died within three years of their funds being invested in the diversified funds, we found that half of all their holdings were in stocks instead of only 20%, as suggested by the IFIC guidelines at the time of the investment.

As well, our examination of clients' files revealed that there had been no disposal of any stocks owned by the clients in order to reduce the risk of overconcentration. Even in cases where we noted that the Office's financial planners had advised that stocks should be sold, such recommendations were not followed. Consequently, some clients who died incurred financial losses because their significant stockholdings were not diversified. The Office had ample time to diversify their assets because these clients had all been with the Office for at least three years at the time of their deaths.

For example, an elderly client whose health was assessed as "fair to poor" had one stockholding that was worth over $3 million, representing more than 80% of the client's assets when the Office did a financial assessment of the client's asset mix in early 2000. We noted that the recommendation of the financial planner to sell at least 75% of this stockholding was never implemented. As well, in August 2000, the Office invested an additional $400,000 of the client's remaining cash in the diversified fund. The decision to invest more of the client's assets in the fund effectively increased this client's exposure to the stock market to over 90% of the client's total assets, when the general rule suggested by IFIC was no more than 12%. By the time this client died three and a half years after the recommendation to sell, the Office had not disposed of any portion of the client's stockholding, and the total stockholdings' market value had fallen from its August 2000 value by over 80%.

Recommendation

To ensure clients' assets are not exposed to undue risk, the Office should regularly review client portfolios and act on a timely basis on recommendations from financial planners with respect to such portfolios.

Office Response

The Office agrees with this recommendation. The staff complement of financial planners has been increased, and recommendations from financial planners are being responded to in a timely manner. A plan for regular review of client portfolios is being developed, beginning with those portfolios at higher risk.

CHARITABLE PROPERTIES PROGRAM

Canada's Constitution gives the provinces responsibility for supervising charities to ensure that charitable assets are used for charitable purposes. The federal government's authority over charities comes primarily from the *Income Tax Act*. That Act makes registered charities exempt from the payment of income tax and allows them to issue receipts for donations. The Charitable Properties Program of the Office protects the public's interests in charitable properties in Ontario by reviewing applications of organizations wanting to incorporate as charitable corporations, investigating complaints and concerns about the use of charitable assets, and conducting litigation to protect the public's interest regarding charities. The principal provincial act that governs the Office's roles and responsibilities in overseeing charitable assets is the *Charities Accounting Act*.

Our review indicated that adequate procedures were in place to review applications for the incorporation of charitable organizations and to handle complaints in a timely manner. However, we noted weaknesses in following up on the status of charities that had been deregistered by the Canada Revenue Agency (CRA) to protect the public's interests. Specifically, the Office was not adequately fulfilling its mandate to ensure that prior donations to deregistered charities were distributed to intended beneficiaries or transferred to successor charities.

Registered charities are required to file an annual return with the CRA and must meet certain requirements of the *Income Tax Act* concerning their expenditures and activities. Periodically, the CRA decides that some charities are to be deregistered from their charity status, meaning that these charities can no longer issue tax deduction receipts to their donors. A charity could be deregistered for various reasons, such as dissolution or the failure of the charity to comply with legislative requirements, including the filing of annual returns on a timely basis. The names of charities deregistered by the CRA are published in the *Canada Gazette*.

In September 2003, the Office initiated a special project by sending letters to about 350 Ontario charitable organizations out of 1,100 that had been deregistered by the CRA between July 2002 and July 2003. The organizations were asked to give the reasons for the revocation of their charitable status and the steps they were taking to wind up operations. They were also asked to provide their proposed plan to distribute their charitable property to charitable beneficiaries or successor charities. More than 300 of these organizations did not respond to the requests.

At the completion of our audit in March 2004, the Office had not made plans to follow up on over 1,000 deregistered charities to ensure that their charitable assets were properly distributed to beneficiaries or transferred to successor charities in order to prevent misuse or misappropriation.

As well, the *Income Tax Act* permits the CRA to release letters explaining the reasons for deregistration on request. A review of the CRA's reasons would enable the Office to target its investigation efforts on organizations that have a high risk of misusing or misappropriating their charitable property. However, we noted that the Office had never requested any such information with regard to the deregistered Ontario charities.

Recommendation

To ensure charitable assets are distributed to intended beneficiaries or successor charities, the Office should review the Canada Revenue Agency's reasons for deregistering charities on a timely basis and immediately follow up on any organizations that may represent a higher risk of misusing or misappropriating their charitable donations.

Office Response

The Office is consulting with the Canada Revenue Agency to obtain information on those Ontario charities that have been deregistered for cause and where there is some reason to suspect that charitable property might be at risk. Receipt of this information will enable the Office to implement this recommendation.