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July 12, 2021

Ms. Carla Male, Chief Financial Officer  
The City of Calgary  
800 MacLeod Trail SE  
Calgary, AB T2P 2M5

Dear Ms. Male:

We have recently completed our audits of the off-site levy ("OSL") schedule of The City of Calgary ("The City") as at and for the years ended December 31, 2016, 2017, 2018, 2019 and 2020.

We examined the accounting procedures and systems of internal control employed by The City relating to OSL. Our examination would not necessarily disclose all weaknesses in the systems of internal control as these examinations are based on selective tests of the accounting records and related data. Furthermore, this letter does not necessarily include all those comments of an accounting, internal control or computer systems nature which a more extensive or special examination of these areas might disclose.

During the course of our OSL audits, we identified certain matters that may be of interest to Administration which have been summarized in this letter. These matters were not significant or material in nature in the context of the schedule taken as a whole and did not impact our ability to issue our audit report. The observations are included in Appendix A attached to this letter.

The following summarizes the management letter points included in Appendix A:

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<b>Year Identified</b>	<b>Title of Observation</b>	<b>Infrastructure Type <sup>(1)</sup></b>
2016-2020	Off-site levies are not tracked within PeopleSoft based on source jobs - Development Agreement, Development Obligation Estimate or Centre City Levy	All
2016-2020	Manual process of tracking and reporting on off-site levy	All
2016-2020	Business Unit involvement in future projects and allocation of funding to existing projects	All
2016-2020	Signed contracts for Developer Obligation Estimate and Developer Agreement amendments	All

(1) "All" is in reference to the infrastructure type for which levies are collected and spent; specifically, these are Transportation, Water/Utilities, Community Services and Police.

The objective of a CAS 805 audit of a single financial statement item conducted in accordance with Canadian generally accepted auditing standards ("Canadian GAAS") is to express an opinion on the presentation, in all material respects, of The City's OSL schedule and notes to the schedule as at and for the years ended December 31, 2016, 2017, 2018, 2019 and 2020 in accordance with Canadian

public sector accounting standards ("PSAS") and is not designed to identify all matters that may be of interest to Administration. Accordingly, an audit would not usually identify all such matters. This letter has been prepared to summarize our observations and recommendations regarding business issues, potential efficiencies and internal controls.

We designed our audits to provide reasonable, but not absolute, assurance of detecting material misstatements whether caused by error or fraud. As part of our examination, we reviewed and evaluated certain aspects of the systems of internal control over OSL financial reporting to the extent we considered necessary in accordance with Canadian GAAS. The main purpose of our review was to assist in determining the nature, extent and timing of our audit tests and to establish the degree of reliance that we could place on selected controls. It was not to determine whether internal controls were adequate for Administration's purposes or to provide assurance on the design or operational effectiveness of internal control over financial reporting of OSL.

The identification of weaknesses in internal control in an audit is influenced by matters such as our assessment of materiality, our preliminary assessment of the risk of material misstatement, the audit approach used and the nature, timing and extent of the auditing procedures conducted. For example, where we use a substantive approach for a particular financial statement assertion, we do not generally perform tests of controls, and where we do perform tests of controls we may vary the nature, timing and extent of our control testing from year to year. Accordingly, our understanding of The City's controls relating to OSL is limited in nature.

Had we been requested to extend our testing of controls to additional financial statement assertions or to perform additional substantive testing beyond what we have judged to be necessary to obtain sufficient and appropriate evidence to support the content of our auditor's report, other matters of interest to Administration may have come to our attention. Accordingly, our audits should not be relied upon to identify all significant deficiencies. A significant deficiency is defined in Canadian Auditing Standard Section 265 as a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

This communication is prepared solely for the information and use of, as applicable, Administration, the Audit Committee, members of City Council and others within The City. Further, this communication is not intended to be and should not be used by anyone other than these specified parties or summarized, quoted from, or otherwise referenced in another "document" or "public oral statement". We accept no responsibility to a third party who uses this communication.

We wish to express our appreciation for the courtesies and cooperation extended to your representatives during our work. We would be pleased to discuss and/or clarify the matters included herein with you further should you wish to do so.

Yours truly,



Chartered Professional Accountants

cc: The Audit Committee of The City of Calgary

## Appendix A - December 31, 2016 to 2020 observations

### **1. Off-site levies are not tracked within PeopleSoft based on source jobs - Development Agreement, Development Obligation Estimate or Centre City Levy**

Years identified – 2016 to 2020

#### **Observation:**

We observed that The Off-site Levy Bylaw (2M2016) (the “bylaw”) does not require The City to track levies collected and spent on an individual Development Agreement (“DA”), Development Obligation Estimate (“DOE”) or Centre City Levy (“CCL”) basis. When levies are collected, they are pooled and then spent on an eligible project as defined in the bylaw. While there is no requirement for The City to track or report levies on an individual DA basis, we note that this would provide beneficial information to users of the external OSL schedules. This would also allow The City to better understand the relationship between levies collected and spent. Specifically, it would allow The City to understand and track which collection period levies collected pertain to and which infrastructure types are utilizing the funds more quickly as compared to others. These insights could provide more fulsome and timely information regarding the effectiveness of the bylaw and an ability to make amendments that better reflect the capital needs of The City and the stakeholders.

#### **Recommendation:**

We recommend the following:

- Administration should consider whether a comprehensive system is required for OSL that is able to track activity by infrastructure type, project and DA that allows for more timely reporting and analysis of the underlying data.
- Administration should consider holding and tracking OSL funds in a separate investment account distinct and separate from other investments of The City, to allow for better tracking and reporting of investment income earned on OSL amounts invested.

#### **Administration’s response:**

- Administration has considered the recommendations above and deems the current process sufficient and in compliance with legislation.
- The City is required to provide full and open disclosure of all off-site levy costs and there is no legislated requirement to provide OSL activity by infrastructure type, project and DA. The nature of how funds are collected adds to the complexity of tracking such activity. The City invoices the Developer over a 3 year term (Year 1: 30%, Year 2: 30% and Year 3: 40%). The initial payment pays for Water Resources infrastructure principal and interest cost. Subsequent invoices are then allocated to Transportation and Community Services where OSL funds are a partial funding source for the project. Overall, the City ensures it is compliant, that OSL is only spent on OSL eligible capital projects and deems the risk of not tracking activity by infrastructure type, project and DA low. Implementation of the first recommendation would require additional staff resourcing and costs. Administration will continue to find ways to enhance reports and control for these transactions.

- Administration agrees that improvement can be made that allow for better tracking and reporting of investment income earned on OSL amounts invested. OSL assets are pooled to achieve economies of scale and to open the opportunity set of investments. Implementation of holding funds in a separate account would be inefficient and could reduce the investment income return on OSL balances (OSL would lose the benefit of the broader City structure). The City's Treasury division has recently moved to a notional separation of assets; OSL has its own asset mix that Administration can point to in a policy and track to underlying investments. In 2020, Administration created an OSL investment income general ledger account to separately track amounts allocated to OSL. Administration believes these recent changes address the recommendation appropriately.

## ***2. Manual process of tracking and reporting on off-site levy***

Years identified – 2016 to 2020

### **Observation:**

We observed that the current method of tracking and reporting OSL information is largely manual. This increases the risk of human error in schedules and calculations, potentially leading to incorrect reporting of OSL balances. In addition, the reporting of OSL is decentralized, where numerous business units and departments utilize different processes and schedules to track various information, increasing the risk that schedules are inconsistent with one another and that OSL balances are reported incorrectly.

This was further evidenced by the following matters identified during our audit procedures:

- a. Finance continuity schedules: We observed that the current method of tracking and reporting OSL financial information requires manual spreadsheets. Specifically, we noted that the OSL tracking workbooks used by the business units to calculate the OSL balances are manually updated as are the OSL continuity schedules used by each of the business units. This increases the risk of human error in schedules and calculations, potentially leading to incorrect reporting of OSL balances. In addition, the tracking of OSL is decentralized where each business unit utilizes different schedules to track the movement in the OSL balances and prepare the necessary journal entries. This increases the risk that the schedules are inconsistent with one another and that the OSL balances reported are incorrect. Lastly, the reports required to audit the utilization and spend activity of OSL balances were not available and had to be recreated at the time of the audit by the Water/Utilities and Transportation business units. This increased the risk that the business units are not reconciling OSL activity on a regular basis.
- b. UDBIS system: We observed that there were cases relating to DAs prior to 2016 where the invoice line description outlining the levy amount and percentage billed were incorrect, but the actual amount billed was correct. This was limited to the UDBIS system that was used prior to 2016. The process required the user to manually update the UDBIS system, including hectares billed and the line item description on the invoice. In limited instances the line item description was not updated correctly. We note that while the description was incorrect, all invoices were billed and collected in accordance with the underlying agreed upon rates and as such this does not result in a misstatement.

- c. Urban Development Online (“UDO”) system: We observed that there were cases where the assessable hectares changed between the Interim Indemnity Agreement (“IIA”) and the Special Clauses Agreement (“SCA”) for DAs prior to 2020, but the credit and re-bill for the updated assessable hectares was not completed by the Strategist. We note that it is not unusual for there to be changes in assessable hectares between the IIA and the SCA as more precise information is obtained once the project is closer to completion. However, this update is made through a manual input of the assessable hectares in UDO. When this change occurs in UDO, the Developer is issued a new invoice or credit note to reflect the correct levy based on updated hectares. We have identified a reportable misstatement of \$173,000 where The City has under collected levies based on incorrect hectares used. We noted that due to the informal and manual nature of the process, erroneous billings could be processed resulting in misstatements to OSL.
- d. Investment income allocation: We observed that the blended yield rate calculation which is used to calculate the investment income is a manual process that can be subject to transposition and formula errors. Additionally, we observed there were timing differences between when the transactions were captured in the third-party investment reports, which are a key input used in the calculation, and when they were included in the blended yield calculation. While this did not result in a reportable misstatement, there is a potential that it could lead to a material misstatement in investment income.

**Recommendation:**

We recommend the following:

*Finance continuity schedules:*

- Administration reviews the processes followed by each department and business unit to ensure OSL activity is tracked and reported consistently. Administration should also evaluate whether all relevant departments and business units are involved in management of OSL.

*UDBIS System:*

- We note that the UDBIS system is no longer used after the 2016 system upgrade to the UDO system. As such, no further action is required.

*UDO System:*

- It is recommended that all users are properly trained on the required processes to ensure accurate billing.
- Any variances between the hectares in the assessments tab within UDO and the hectares billed should be reviewed on a periodic basis and investigated.
- The assessable hectare changes in the IIA and SCAs should be reviewed on a periodic basis to ensure that the appropriate hectares are invoiced and any credit and/or re-bills are issued in a timely manner.
- Administration performs routine spot-checks within UDO and compares the information to the corresponding agreements to ensure that billing is accurate and complete. Additional consideration should be made to add preventative controls in place to omit this from occurring.

*Investment income allocation:*

- Consistent with the first observation, we recommend that Administration considers the use of more sophisticated software to calculate and track the blended yield rate calculation to ensure that correct inputs are being used to calculate the blended yield rate. We further recommend that individuals with appropriate knowledge of the underlying spreadsheets review the documentation for consistency, completeness and accuracy.

### **Administration's response:**

- Administration agrees with the finance continuity schedule recommendation. Administration has completed numerous process and reporting improvements based on the City Auditor Off-site Levy Annual Reporting Audit – AC2019-1241 which includes creating policies and procedures, setting up specific balance sheet accounts, analyzing, reconciling and segregating OSL & Non-OSL items, developed procedures for maximum OSL spend, developed procedures for interest earned, developed a consistent approach for OSL reporting, etc. from December 1, 2020 through to 2021 which would not have yet been applied during the period of the audit from 2016-2020. Administration will strive to continue to improve consistent tracking of OSL activity and reporting. In addition, overall OSL management will be addressed through the committees that have been created in 2020.
- Administration agrees with the UDO System recommendation. Administration will create a monitoring control to detect misalignments between hectares on the master UDO job and the hectares used on assessment billings. This will be done in a business unit dashboard and monitored and reviewed on a quarterly basis. Time to be implemented and complete by Q4 2021.
- Administration agrees with the investment income allocation. Administration will investigate solutions to ensure the blended rate yield is calculated in an accurate and consistent manner. Options may include dedicated software, if available and/or automation of the process to eliminate some of the manual entries where transposition and formula errors could occur. Investigation will occur by Q4 2021.
- Administration will be implementing a more rigorous spreadsheet review process to ensure consistency, completeness and accuracy. To be completed by Q4 2021.

### **3. Business Unit involvement in future projects and allocation of financing to existing projects**

Years identified – 2016 to 2020

#### **Observation:**

We observed that the process of allocating financing sources to projects was decentralized and inconsistent amongst infrastructure types. Specifically, if there were multiple financing sources available for a project (such as OSL, grants or internal sources), there is lack of formal process to dictate which sources should be utilized and how much should be utilized from each source. Each business unit has developed their own process to prioritize and allocate financing. We note that we found no misstatements related to the use and allocation of funds.

We also observed that there were significant unspent amounts in the OSL balance for Community Services and Police. Some of these amounts were collected prior to 2013.

- a. Community Services: There is \$16.5M in unspent OSL funds that were collected prior to 2013 as at December 31, 2020.
- b. Police: There is \$10.9M in unspent OSL funds that were collected prior to 2013 as at December 31, 2020.

### **Recommendation:**

We recommend the following:

- A formal process should be established for financing sources to projects. We also recommend that this process allow for Administration to adjust as excess financing becomes available from any financing source.
- Administration should ensure OSL projects are identified and approved in a timely manner and that projects are using the most efficient financing model by ensuring OSL is spent first.
- Administration should consider if the underlying assumptions driving the levy rates are appropriate or need to be reassessed based on historical collections and usage of levies relative to other financing sources.
- Administration should perform analysis to ensure the maximum potential OSL eligible amounts for each project are being utilized.
- Administration should review the application of financing for projects and if other financing sources are not readily available to consider fully financing the project from OSL, if allowable under the Bylaw.
- While these recommendations are for the organization as a whole, we understand that consideration may need to be given to the application of these recommendations to each Business Unit as there may be different processes in place at each Business Unit based on the nature and timing of the financing sources.

### **Administration's response:**

Finance agrees with the recommendations above. Finance follows Capital Infrastructure Investment Principles to optimize financing sources. The financing process is the order of application of the funding. The development of a fiscally sustainable corporate approach (where possible) to financing will maximize The City's opportunity to provide capital investments that support service delivery. Finance will review the current financing process across departments and develop more detailed eligibility criteria that are consistent and efficient. This will be completed after the Corporate realignment and as part of 2022 OSL By-law.

## ***4. Signed contracts for Developer Obligation Estimate and Developer Agreement amendments***

Years identified – 2016 to 2019

### **Observation:**

We observed the following matters during our audit procedures:

- a. Signed contract amendments for changes to the SCA: We observed that there were cases where there was a difference in hectares billed on the invoice as compared to assessable hectares included in the SCA. This situation occurs when the assessable hectares are updated for a variety of reasons after there is a signed SCA agreement. Our audit procedures performed noted that Developers are informed of these changes and are invoiced based on the correct hectares; however, a new SCA or contract amendment with the updated hectares is not created.

- b. Development Obligation Estimate process: We observed that there were situations where the payment of OSL occurred before an invoice was issued. This related to instances of DOE projects. DOE projects occur when a Developer is seeking to develop a single lot (as an example, remove the current dwelling and add a new dwelling). The Developer requires a development permit which includes a condition to pay OSL for established areas (which are in accordance with the rates per the bylaw). Based on the details of the development permit, a levy calculation is prepared in UDO and the estimate is provided to the Developer. The noted levy amount in the estimate is required to be paid or the developer must enter into an OSL Agreement to defer payment prior to the release of the Development Permit (including conditions of the Development Permit being satisfied). Once the Developer pays the estimated amount, The City issues an invoice in replace of a receipt. In addition, we observed that there are no signed agreements for DOE projects. While we recognize that the Developer has accepted the levy amount through payment of the DOE estimate provided, we note that lack of DOE contracts could result in incorrect amounts being billed and collected.

**Recommendation:**

We recommend the following:

- Any changes made to the final SCA require a contract amendment that is signed by The City and the Developer to ensure accuracy of the assessable hectares. It should be noted that as of 2020 the process has been updated whereas there is only one DA required which is finalized and signed by all parties before invoicing. However, if the situation arises where an amendment to this agreement is required, we recommend that a contract amendment is prepared and signed by both parties.
- The process should be updated so that there is a signed agreement for all levies collected, including DOE projects. While a signed agreement is the best evidence of Developer acceptance, alternative methods are suitable so long as proof of Developer acceptance is formally tracked and maintained. We recommend that this Developer acceptance occur at the time the permit is negotiated and issued. In addition, it is recommended that The City provide an invoice prior to payment to ensure that the correct amount is being paid by the Developer.

**Administration's response:**

Administration agrees with any changes made to the final SCA require a contract amendment that is signed by The City and the Developer to ensure accuracy of the assessable hectares. Administration will add process/tools in UDO to more completely document and report on any area changes that require a credit/rebilling if invoicing has already occurred. A template will be developed to note the changes (area before and after) and will be regarded as an addendum to the final agreement (SCA for 2019 and older jobs and DA for 2020 and newer jobs). Time frame: Q4 2021.

Administration has considered the recommendation for DOE projects and deems the current process sufficient. It is important to note that this observation did not result in a misstatement of the OSL schedules and the risk of misstatement is low. Currently, Administration has followed the principal that the Development Permit (DP) serves as the binding contract. With completion of the review of the DP and associated calculation of levy owing, the customer is provided with a detailed report showing exact calculations and area/units and this is held as the binding amount. For those complex DP jobs that may change through the DP review, the Public Infrastructure team will complete a final review of the job and determine if changes to levy owing are required and if so provide this update to the developer. If the customer would like to delay payment of the off-site levies (if owing) then the customer can request an Off-Site Levy Agreement be put in place.