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January 12, 2016

Mr. Eric Sawyer
Chief Financial Officer
The City of Calgary
800 MacLeod Trail SE
Calgary, AB T2P 2M5

Dear Mr. Sawyer:

During the course of our December 31, 2014 audit, we identified matters that may be of interest to Administration and provided a letter of recommendation to Administration and the Audit Committee on June 18, 2015. These matters were not significant or material in nature in the context of the December 31, 2014 financial statements taken as whole and did not impact our ability to issue our audit report. We have now provided an update on these matters based on our interim audit procedures performed through to November 2015.

This communication is prepared solely for the information and use of, as applicable, Administration, the Audit Committee, members of 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 any third party who uses this communication.

We wish to express our appreciation for the courtesies and cooperation extended to our staff during the course of 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, Chartered Accountants

cc: The Audit Committee of The City of Calgary

December 31, 2014 Year End Observations

Background

We note that Administration has continued to expend focus and effort on the accounting of tangible capital assets (“TCA”), as well as continuous staff education and training. As a result of this effort and attention during the year ended December 31, 2014, Administration identified additional TCA errors that related to prior periods. While these errors impacted fiscals 2009 through to 2013, it should be noted that a majority of the errors related to fiscal 2013 and were isolated in nature. Accordingly, the December 31, 2013 financial statements were adjusted.

As a result of these prior period adjustments, TCA remained an area of audit focus and an area of significant risk during the 2014 audit and accordingly, many of the 2014 year-end observations relate to TCA account balances and related processes.

Attached is a summary of the 2014 year-end observations identified, with an update on these observations based on work performed through to November 2015, noted as “Administration and Auditor Update –January 2016” in the attached table. Appendix A and B, relating to fiscal 2013 and 2012 year-ends, respectively, are attached as background information, referenced accordingly in the 2014 year-end observation summary.

As was communicated in our update to the prior year management letter presented at the June 18, 2015 Audit Committee meeting, we note that Administration is in the process of implementing recommendations from the prior years’ management letters relating to TCA accounting balances and related processes. Significant progress has been made by Administration during the year in implementing the TCA Project Charter through a formal TCA Steering Committee, with the overall objective of developing TCA solutions and implementing processes that are consistent throughout all business units, simple to implement and which, when fully implemented, will allow for overall compliance with TCA policies by all business units. Specifically, a formal review of the Machinery and Equipment asset category was completed during fiscal 2015 and appropriate changes were implemented with the plan to review other major asset categories during fiscal 2016. We also note that a TCA Costing System was approved which will assist in implementing many of our recommendations relating to TCA account balances.

Throughout the year, we have held many discussions with Administration on the on-going implementation of the TCA Project Charter and, where applicable, have applied audit procedures to any changes in processes or policies implemented during fiscal 2015. We appreciate Administration’s continued efforts to implement the recommendations that were issued in the prior years’ management letters during fiscal 2015. We will continue to work with Administration on the on-going implementation of the TCA Project Charter.

December 31, 2014 Year End Observations (Amendments underlined on pages 10 and 11)

#	Observation Title	Year Identified	Appendix Reference	Item	2014 Observation (Including an update on prior year recommendations)	2014 Recommendation (based on audit procedures performed during the 2014 year end audit)	Administration Response June 2015 and January 2016 update	Completion Timeline	Process Owner / Recommendation Status
1	Tangible Capital Assets Untimely review of capital project costs, accruals and work in progress	2013	A	1.a. (i)	<p>In 2013, we noted "to ensure that the project costs, accruals and work in progress are accounted for on a timely basis, we recommended the implementation of a formalized process to review capital expenditures and reconciliations throughout the year versus at the end of the year, which will reduce the amount of review of capital projects at year-end when business unit personnel are focused on other financial reporting finalization matters".</p> <p>During the performance of our 2014 audit procedures, we noted that a review of project costs, accruals and work in progress was occurring within each business unit. However, some business units are reviewing this information on a monthly basis whereas other business units are completing this review quarterly or semi-annually. There is lack of consistency relating to the timeliness of this process amongst business units and as a result, there may be a risk that there is a large volume of information for business units to process at year-end resulting in possible errors that could be rectified earlier.</p>	<p>We recommend that (new recommendation from 2014):</p> <ul style="list-style-type: none"> • All business units review project costs, accruals and work in progress on the same frequency (monthly) to ensure consistency across business units and to further ensure that all capital expenditures are accounted for appropriately to avoid a review of a significant volume of projects and TCA costs close to year-end. 	<p>Administration agrees with this recommendation. During 2014, Administration had set up a TCA Project team to develop a comprehensive strategy and work plan with the goal of comply, simplify, and consistency. As part of the work plan, the root causes of TCA reporting are being investigated and analyzed.</p> <p>Currently, all Business Units review capital projects during the year however the determination of the appropriate solution to be applied consistently will need to be assessed as part of the TCA Project.</p>	<p>Capital project review process to be assessed during 2015 and the decision of the appropriate process to be implemented will be made in 2016.</p>	<p>City Treasurer, Director of Finance & Supply</p> <p>In progress</p>
						<p>Administration update (January 2016)</p> <p>Administration continues to agree with this recommendation. During 2015, the TCA project team has started a review to determine a consistent process to be applied on accounting for TCA costs and capital expenditures.</p>	<p>Administration update (January 2016)</p> <p>The TCA project team continues to assess the capital project review process and the decision of the appropriate process to be implemented will be made in 2016.</p>	<p>Auditor update (January 2016)</p> <p>In progress</p> <p>We are working with Administration and their progress on developing a consistently applied and simplified TCA policy.</p> <p>We will continue to test the TCA processes</p>	

									<p>implemented by Administration as they are put into action and will communicate any deficiencies to both Administration and the Audit Committee.</p> <p>During our interim testing for the year ended December 31, 2015, we tested the initial implementation of the revised machinery and equipment TCA policy. We will further test this new policy during our year end procedures.</p>
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2	Tangible Capital Assets Untimely review of capital project costs, accruals and work in progress	2013	A	1.a. (ii)	<p>In 2013, we communicated in our observation that "There is, at times, a significant delay in "hand-off" of TCA assets between business units".</p> <p>During the performance of our 2014 audit procedures, we continue to note that there exists a delay in the "hand-off" of TCA assets between business units. As such, there may be an increased risk that business units could be recording the same TCA costs twice due to the time delay noted in the "hand-off" of projects.</p>	<p>We continue to recommend that:</p> <ul style="list-style-type: none"> • Business units formalize the timing and process of "hand-off packages" between business units. This would require enhanced communication between business units and implementation of formal processes to review project status on an on-going basis throughout the project's life cycle. A timeline of when reviews should occur should be formalized. 	<p>Administration continues to agree with this recommendation. During 2014, Administration had set up a TCA Project team to develop a comprehensive strategy and work plan with the goal of comply, simplify, and consistency. As part of the work plan, documentation of the process of "hand-off packages" between business units starting in Q3, 2015.</p> <p>Administration update (January 2016)</p> <p>Administration continues to agree with this recommendation. The TCA Project team has begun reviewing the multi-BU multi-year process to determine a consistent approach and a formalized process.</p>	<p>Capital project review process to be assessed during 2015 and the decision of the appropriate process to be implemented will be made in 2016.</p> <p>Administration update (January 2016)</p> <p>The TCA project team continues to assess the process and the decision of the appropriate process to be implemented will be made in 2016.</p>	<p>City Treasurer, Director of Finance & Supply</p> <p>In progress</p> <p>Auditor update (January 2016)</p> <p>In progress</p> <p>We are working with Administration on their progress on developing a consistently applied and simplified TCA policy.</p> <p>We will continue to test the TCA processes implemented by Administration as they are put into action and will communicate any deficiencies to both Administration and the Audit Committee.</p>
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3	Tangible Capital Assets Untimely review of capital project costs, accruals and work in progress	2013	A	1.a. (iii)	<p>In 2013, we communicated in our observation that "Accurate TCA accounting and reporting relies, in some areas, on engineering drawings and other related information. We observed that the Geographic Information System ("GIS") asset registry contains the original data related to the quantities recorded for many Roads and Parks assets".</p> <p>In 2014, we noted that there remains reliance on the asset management systems as part of the process for TCA accounting. In addition, we noted that some business units rely on the LINDA system to identify any donated land in the year. The information within the LINDA system initiates with the developer, which at times may be a lengthy process. Therefore, recording of these donated assets may not be occurring in a timely manner such that assets could be recorded in the incorrect fiscal period.</p>	<p>We continue to recommend that:</p> <ul style="list-style-type: none"> • TCA accounting and reporting be linked to invoice costing, as opposed to asset management systems; and <p>We recommend that (new recommendation from 2014):</p> <ul style="list-style-type: none"> • The business units investigate improvements that can be made to the land donation process to minimize the delay in uploading of these assets into The City's accounting records. 	<p>Administration continues to agree with this recommendation. Understanding the benefit of TCA linked to an invoice costing tool, this will be assessed by Administration.</p> <p>Administration agrees with this recommendation and will be looking into further process control improvements to ensure timely recording of land donations.</p> <p>Administration update (January 2016)</p> <p>Administration continues to agree with this recommendation. Understanding the benefit of TCA linked to an invoice costing tool is continually being assessed by Administration. As a result, the TCA Costing System project (an invoice costing tool) was approved on November 5, 2015 with an anticipated implementation date of April 2017.</p> <p>Administration agrees with this recommendation. The TCA finance team plans to look into the land and land improvement components starting Q4, 2016 and work to develop a framework in seeking an ultimate solution. During the 2015 year, additional controls have been put in place in identifying the more reliable source of donated land information and reconciling discrepancies noted in a more timely manner.</p>	<p>The invoice costing tool review will be assessed during 2015 and a decision of the appropriate invoice costing tool will be made in 2016.</p> <p>Process improvement controls in relation to donated land to be identified in 2015.</p> <p>Administration update (January 2016)</p> <p>The TCA Costing System project was approved on November 5, 2015 with an anticipated implementation date of April 2017.</p> <p>Process improvement controls in relation to donated land continues to be assessed in 2016.</p>	<p>Finance Manager, Corporate Financial Reporting</p> <p>In progress</p> <p>Auditor update (January 2016)</p> <p>In progress.</p> <p>We will review the implementation and related processes / policies relating to the invoice costing system once implemented in 2017.</p> <p>We will plan to review the updated controls relating to donated land once implemented by Administration.</p>
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4	Tangible Capital Assets Untimely review of capital project costs, accruals and work in progress	2013	A	1.a. (iv)	<p>In 2013, we communicated in our observation that "There is a significant delay in review of capital project costing as TCA accounting and reporting is linked to asset management systems in Roads, Transportation Infrastructure, Parks and Water business units, as opposed to being linked to invoice costing".</p> <p>In 2014 we noted that there remains reliance on asset management reporting for TCA accounting. We also continue to note that accounting for TCA transactions is still a manual process whereby spreadsheets are utilized to track movement in the TCA balance.</p>	<p>We continue to recommend that:</p> <ul style="list-style-type: none"> • TCA accounting and reporting be linked to invoice costing, as opposed to asset management systems. 	Please refer to above response #3	Please refer to above response #3	<p>Finance Manager, Corporate Financial Reporting</p> <p>In progress</p>
5	Tangible Capital Assets Untimely review of capital project costs, accruals and work in progress	2013	A	1.a. (v)	<p>In 2013, we communicated in our observation that we noted "Errors with disposals not being recorded in the fiscal year in which they occurred, donated assets are not being recorded and double counting of land as both TCA and land inventory". During our 2014 audit procedures, we noted that items may be resultant from the use of manual spreadsheets, which would be rectified with the implementation of an automated system to track the related assets.</p> <p>We continue to note that accounting for TCA transactions is still a manual process whereby spreadsheets are utilized to track movement in the TCA balance.</p>	<p>With the implementation of the various recommendations noted relating to TCA accounting and processes, these errors and issues identified will be resolved.</p>	<p>Administration continues to agree with this recommendation. During 2014, Administration had set up a TCA Project team to develop a comprehensive strategy and work plan with the goal of comply, simplify, and consistency.</p> <p>Administration update (January 2016)</p> <p>Administration continues to agree with this recommendation. The TCA Project team continues to develop a comprehensive strategy and work plan with the goal of comply, simplify, and consistency.</p> <p>The TCA Costing System project has been approved on November 5th, 2015 with an anticipated implementation date of April 2017.</p>	<p>Capital project review process to be assessed during 2015 and the decision of the appropriate process to be implemented will be made in 2016.</p> <p>Administration update (January 2016)</p> <p>Capital project review process continues to be assessed and the decision of the appropriate process to be implemented will be made in 2016.</p> <p>The TCA costing project was approved on November 5, 2015 with an anticipated implementation date of April 2017.</p>	<p>City Treasurer, Director of Finance & Supply</p> <p>In progress</p> <p>Auditor update (January 2016)</p> <p>In progress.</p> <p>We will review the implementation and related processes / policies relating to the invoice costing system once implemented in 2017.</p>

6	Tangible Capital Assets Training	2013	A	1.b.	<p>In 2013, we recommended that "In order to ensure that there are consistent policies throughout The City and that key personnel in the TCA process have the appropriate knowledge of TCA policies and procedures, we recommend the following be considered by business units in conjunction with the corporate finance group in relation to training:</p> <ul style="list-style-type: none"> • Schedule training sessions multiple times throughout the year to be flexible with business unit schedules and increase attendance; • Encourage or provide a mechanism (for example, regular meetings) for cross-sharing of information between business units so best practices and lessons learned are communicated throughout the business units; • Increase technical TCA training for operations personnel and project managers responsible for categorizing TCA expenditures and identification of TCA at the project level; and • Simplify TCA processes into overall flow charts and step by step guidance so that new personnel can easily and accurately pick up TCA reporting responsibilities". <p>In 2014, we noted that TCA training sessions were held throughout the year and were mandatory for Finance and Operations personnel. However, based on discussions with several business units, it appears that project managers and accounting personnel within the business units do not appear to have a concrete and clear understanding of TCA items/transactions. This is evidenced through the uncertainty of accounting for "one off" transactions or unusual events. For example, within the Calgary Police Service business unit, several prior year flood transactions were incorrectly accounted for, as well as in OLSH land inventory was inappropriately classified.</p>	<p>We continue to recommend that:</p> <ol style="list-style-type: none"> 1 - Scheduled training sessions continue to occur multiple times throughout the year to be flexible with business unit schedules and increase attendance. This will allow for business units to pose questions relating to unusual transactions at these events and will ensure that new accounting for TCA transactions are completed in a consistent manner across the Organization; 2 - A mechanism for cross-sharing of information between business units is developed so best practices and lessons learned are communicated throughout the business units; 3 - An increase in technical TCA training for operations personnel and project managers responsible for categorizing TCA expenditures and identification of TCA at the project level is completed; and 4 - A simplification of the TCA processes into overall flow charts and step by step guidance so that new personnel can easily and accurately pick up TCA reporting responsibilities is developed. <p>We recommend that (new recommendation from 2014):</p> <ol style="list-style-type: none"> 5 - A mechanism for business unit personnel be developed so that any uncertainties or questions relating to treatment of TCA transactions may be addressed during touch point meetings scheduled at regular times throughout the year between key business unit and finance team personnel. 	<p>Administration continues to agree with this recommendation with points 1 and 5. Scheduled training sessions will continue to occur multiple times throughout the year to be flexible with business unit schedules and ensuring the appropriate level of attendance. Communication will also be developed to ensure business unit personnel have a mechanism to ask for clarification relating to treatment of TCA.</p> <p>With regards to points 2, 3 and 4 these items will be addressed as part of the overall TCA Project capital project review with the goal of comply, simplify, and consistency.</p> <p>Administration update (January 2016)</p> <p>Administration continues to agree with this recommendation. In regards to points 1 and 5.</p> <ul style="list-style-type: none"> • Scheduled training sessions have continued to occur multiple times throughout the year to be flexible with business unit schedules and ensuring the appropriate level of attendance. • Communication mechanisms such as lunch and learn sessions, one-on-one meetings and online Q&A postings have been developed to ensure business unit personnel have a mechanism to ask for clarification relating to the treatment of TCA. <p>With regards to points 2, 3, and 4, a consultant has</p>	<p>Q4 2015</p> <p>Capital project review process to be assessed during 2015 and the decision of the appropriate process to be implemented will be made in 2016.</p> <p>Administration update (January 2016)</p> <p>The Q4 2015 timeline was achieved</p> <p>Capital project review process continues to be assessed and the decision of the appropriate process to be implemented will be made in 2016.</p>	<p>Finance Manager, Corporate Financial Reporting</p> <p>City Treasurer, Director of Finance & Supply</p> <p>In progress</p> <p>Auditor update (January 2016)</p> <p>In progress</p> <p>In regards to points 1 and 5 we noted;</p> <ul style="list-style-type: none"> • Scheduled TCA training sessions occurred throughout the year with various Business Units. • Communication has been developed to ensure business unit personnel have a mechanism to ask for clarification relating to treatment of TCA. <p>With regards to points 2, 3 and 4 we will work with</p>
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							<p>been engaged by Administration in Q3 2015 to review the current process flow charts and to provide overall recommendations on improving the process.</p>		<p>Administration to review the process flow charts and improvements made once developed and implemented.</p>
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7	REVISED Human Resources Removal of terminated employees	2013	A	2	<p>In the prior year, we observed that terminated employees were not removed from the PeopleSoft system in a timely manner and, in certain cases, continued to be paid following the date of termination beyond regular vacation or standard pay that would be owing to the employee. In the prior year, this recommendation included two parts. The first issue resulted from the untimely communication by business units to Human Resources of the change in status of employees and the second issue related to the removal of user access within information technology based on the change in employee status (item #12 below).</p> <p>For the year ended December 31, 2014, we obtained a listing from Administration of all terminated employees during the year and noted that it took an average of nine business days for a terminated employee to be removed from the PeopleSoft system. While this timeframe may be acceptable to The City, a clear definition of when a terminated employee should be removed from PeopleSoft should be documented and clearly communicated to all business units. Furthermore, we identified one employee that was on short term leave who, subsequent to termination, continued to be paid their salary for two pay periods. The total amount paid to the employee was not material (less than \$5,000) and The City is currently seeking repayment. We note that the payment to terminated employees continues to be an issue as has been identified in prior year management letter points. We noted that Administration sent out "Take 5" communications to business units two times in 2014 (September and December), as a reminder for business units to frequently review their pay reports and notify Human Resources when an employee's status was updated. We had indicated in our prior year recommendation that a control be developed to ensure that terminated employees were removed from PeopleSoft in a timely manner. Based on our year-end procedures, we noted that a process was implemented whereby Human Resources generates a report from PeopleSoft every two weeks of all terminated employees. Human Resources then performs a random check of specific terminated employees within PeopleSoft to confirm that their employment status had</p>	<p>We continue to recommend that:</p> <ul style="list-style-type: none"> • All business unit supervisors follow The City policy to inform Human Resources of terminated employees on a timely basis. The City should communicate to the business units what they deem to be an acceptable time frame for notification of termination to the Human Resources department (i.e. define what constitutes "timely"); and • That Human Resources perform a check of all employees within approximately two weeks of termination, to ensure timely removal of the employee from the PeopleSoft system and discontinuation of pay. 	<p>Based on Administration's internal communication Take 5 notices in 2015 and updating the Payroll Procedure Manual, Administration has observed improvements to this item as no overpayments has been made. As a result, HR will continue with the internal communication Take 5 notices in 2016 (semi-annual) to the City's supervisors on what an acceptable timeframe is for notification of termination.</p> <p>Administration continues to agree with this recommendation. Bi-weekly checks are done by the Senior Pay Analyst to ensure the Pay Administrators have removed all scheduled time post termination for employee departures processed in the current pay period. In addition, the Senior Pay Analyst changes the schedule type to "NONE" to prevent any reload of schedules. Ad-hoc / random audits are performed monthly by the Training, Audit and Documentation Specialist in the area to ensure the above process is being done on a consistent basis.</p> <p>Administration update (January 2016)</p> <p>Based on Administration's internal communication Take 5 notices in 2015 and updating the Payroll Procedure Manual. Administration has observed improvements to this item</p>	<p>Pay Services has scheduled a Take 5 reminder for Department ID owners. This information was communicated on June 12, 2015 and another notice will be issued in December 2015. Completed. A process reminder was sent out to Pay Services Staff May 2015 and Payroll Procedure Manual updated to clarify this requirement.</p> <p>Administration update (January 2016)</p> <p>2016</p>	<p><u>Department id owners supported by HR-Manager, Pay Services</u></p> <p>In progress</p> <p>Auditor update (January 2016)</p> <p>In progress</p> <p>We noted that communication via "Take 5" notices were sent to Business units ("BU's") indicating</p>
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				<p>been updated. However, this process does not address the risk that business units are not informing Human Resources of terminated employees in a timely manner.</p>		<p><u>as no overpayments has been made. As a result, HR will continue with the internal communication Take 5 notices in 2016 (semi-annual) to the City's supervisors on what an acceptable timeframe for notification of termination is.</u></p>	<p>the expectation of communication between BU's and HR of employee terminations as soon as they are aware an employee is leaving and no later than the last day of work. However based on our audit procedures performed in November 2015, 6 out of 25 terminations selected for testing indicated that HR was not notified of the termination by the respective BU until after the effective termination date of the employee. Accordingly, the control to ensure timely removal of terminated employees has not been implemented nor is it operating effectively. Business units are not communicating employee terminations in a timely manner to HR.</p> <p>We do however note that there were no salary payments to terminated employees subsequent to their termination dates for the samples we selected for testing.</p>
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8	Item presented in camera
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Prior year's recommendations that have been partially closed and carried forward to current year.

#	Observation	Year Identified	Appendix	Item	Prior Year Observation	2014 Recommendation (based on audit procedures performed during the 2014 year end audit)	Administration Response June 2015 and January 2016 update	Completion Timeline	Observation Status
9	Tangible Capital Assets Capital Projects Monitoring	2012	B	1	Our 2012 observation indicated the following: "We understand that Administration is currently developing a process to monitor the status changes of on-going capital projects. This will allow business units to ensure that work-in-progress balances are appropriately accounted for at year-end. We recommend that business units maintain a listing of on-going projects with anticipated completion dates and ensure the projects are monitored throughout the year in the event that the project is completed and needs to be capitalized as TCA. Furthermore, it is recommended this listing be reviewed periodically and the project status be formally documented. This will result in a systematic and formal process to monitor capital projects, minimizing any risk of incorrect assessment of capital projects".	We noted that: • Business units are required annually to confirm to Corporate Finance the anticipated completion dates of all projects that are in progress; and • Business units have commenced reviewing work in progress costs on a more frequent basis, however the frequency of this review and input of these costs into the TCA module is not consistently completed on the same frequency for all business units (refer to recommendation # 1 above for outstanding observation).	Recommendation has been partially addressed refer to #1 above for outstanding recommendation		
10	Information Technology Removal of Employee Access	2012	B	2	Our 2012 observation indicated the following: "The City employs, approximately over 10,000 employees. There are instances when user access needs to be removed or revised based on either employee departures or changes in roles and positions. During our testing of access termination at the network and application level, we noted a number of instances where access was not disabled on a timely basis. While access is removed on a timely basis once Enterprise Support Systems ("ESS") is notified of a change, the timeliness of the notification from Human Resources / Pay Services to ESS is an issue".	We noted that: • Once ESS is notified of a change by the Human Resources department an employee's access is removed or changed within 24 hours. However, the timeliness of the notification from the business units to Human Resources remains to be an issue (refer to #7 above for outstanding observation).	Recommendation has been partially addressed refer to #7 for outstanding recommendation		

Appendix A - December 31, 2013 Year End Observations

1. Tangible Capital Assets

Tangible Capital Assets (“TCA”) of The City are significant economic resources and a key component of cost in the delivery of many municipal programs and services and one of the largest balances on The City’s consolidated financial statements. The December 31, 2013 TCA balance is \$13.7 billion (net of amortization). Since the initial adoption of Section 3150 which was effective for fiscal 2009, Administration has continued to refine and improve The City’s capital asset accounting and management systems, and there have been continued efforts to educate and train finance staff within the business units on TCA accounting, management and reporting.

During the finalization of the 2013 financial statements, and potentially due to the 2013 flood, increased focus and attention was exerted on a wide range of TCA matters and Administration identified errors in prior years TCA balances relating to several business units that hold significant TCA balances. The errors related to such matters as in-service date errors, non-TCA items recorded as work in progress, work in progress recorded as non-TCA, disposals not recorded in the fiscal period in which they occurred, double counting of land as both TCA and land inventory and a land donation not recorded. These errors impacted fiscals 2009 through to 2012, including amounts related to original 2009 opening balances and therefore, 2012 balances were restated with a \$14.9 million decrease in each of the TCA and accumulated surplus balances, a \$20.9 million increase in revenues and a \$50.5 million increase in expenditures.

1.a. Untimely review of capital project costs, accruals and work in progress

Observation / Implication

2012 TCA Balances

During our audit procedures performed to test the 2012 restated balances, including discussions held with Administration and business unit personnel involved in TCA reporting, we noted that there were various practices within the overall TCA accounting and reporting processes within certain business units which require significant improvement in order to improve the accuracy and timeliness of TCA reporting.

Specific matters noted include:

- (i) An untimely accounting consideration of the appropriate classification of capital projects, including projects which involve TCA and work in progress in several business units such as Water, Roads, Transportation Infrastructure and Parks, the accounting treatment of capital projects and resulting capitalization of expenditures is not performed in a timely manner. The final accounting consideration and treatment of capital projects are often performed at the end of the year when the consolidated annual financial statements are being finalized, or even in the subsequent year(s) following the completion of the project. This untimely accounting assessment has resulted in costs being incorrectly capitalized as work in progress versus being recorded as TCA (and amortized) or incorrectly capitalized as work in progress, instead of being expensed. In other cases, amounts remaining to be properly accounted for are expensed rather than capitalized.

We also noted that there are challenges associated with the timely and appropriate accounting treatment related to projects which have been transferred from the responsibility of one department to another – for example Transportation Infrastructure is required to transition projects to the Roads business unit. There is, at times, a significant delay in this “hand-off”, or inaccuracies within the information exchanged on the projects, causing delays in timely accounting by the business unit as well as inaccurate reporting of TCA balances.

- (ii) Accurate TCA accounting and reporting relies, in some areas, on engineering drawings and other related information - we observed that the Geographic Information System (“GIS”) asset registry contains the original data related to the quantities recorded for many Roads and Parks assets. These costs cannot be recorded in the system until engineering drawings are received by the business unit from operations. There are often extensive delays (at times, even years following the completion of the project, e.g. the West LRT) in obtaining these drawings resulting in consequent delays in the accounting and reporting of underlying TCA balances for these two business units. TCA accounting must then be based on estimates and accruals until such time as the final drawings are received from operations.
- (iii) We also note that there is a significant delay in review of capital project costing as TCA accounting and reporting is linked to asset management systems in Roads, Transportation Infrastructure, Parks and Water business units, as opposed to being linked to invoice costing. This approach frequently causes delays in the final accounting treatment applied to such projects. As final review of asset accounting is, for the most part, completed at the end of the project, all costs throughout the project are often included temporarily as TCA and then re-classified at the end of the project to determine the appropriate classification as TCA or non-TCA. The current process has therefore resulted in errors in TCA balances as discussed in (i) above, albeit errors that are a greater symptom of timeliness than of eventual and final accuracy.
- (iv) We also noted errors with disposals not being recorded in the fiscal year in which they occurred, donated assets not being recorded and double counting of land as both TCA and land inventory.

2013 TCA Balances

During our audit procedures performed on 2013 TCA balances, we noted that the issues identified in the prior periods also impacted the accounting of current year TCA, for example, in the Parks and Water business units, we identified the incorrect recording of expenditures as betterments or repairs expense relating to costs incurred due to the 2013 Flood. These costs, albeit not material or significant, were not appropriately analyzed as to whether the expenditure represented betterment to the asset to be recorded as TCA or repair to the asset to be expensed and there is risk of potential additional errors in the future if this matter is not addressed.

In the absence of formal processes and non-compliance with formal processes in place resulting in control deficiencies, the TCA balances are susceptible to error as evidenced through the identification of errors in the prior and current periods. As The City works towards alignment of financial reporting with amortization being considered in the departmental budgeting and accountability process (refer to recommendation 4c in Appendix B), it will be important to accurately account and report TCA balances as there is the potential to be implications related to The City's asset full life-cycle maintenance expenditures and depreciation balances related to budgeted amounts for each on a department level.

Recommendation

The adoption of Section 3150 was effective for fiscal 2009 and there have been significant efforts to ensure successful implementation of the standard. There are also many unique "City-specific" issues, system capabilities, unique accounting situations and cost-benefit considerations that have influenced the success of this transition.

However, as evidenced by the prior period errors, which were wide ranging, as they resulted from many different factors and impacted TCA accounts in both directions (increases and decreases to TCA balances on the statement of financial position), as well as impacting several business units, we recommend that a thorough review of the processes and controls in place relating to TCA accounting and reporting be undertaken at this time to move expediently to a sound and complete final conclusion to the accounting processes, systems and controls related to TCA.

Specifically, to ensure that the project costs, accruals and work in progress are accounted for on a timely basis, we recommend the implementation of a formalized process to review capital expenditures and reconciliations throughout the year versus at the end of the year which will reduce the amount of review of capital projects at year-end when business unit personnel are focused on other financial reporting finalization matters.

We also recommend that business units formalize the timing and process of "hand-off packages" between business units. This would require enhanced communication between business units and implementation of formal processes to review project status on an on-going basis throughout the project's life cycle.

Further, as noted above, TCA accounting and reporting is linked to asset management systems for certain business units and there is a benefit to implementing processes which allow for accounting of TCA to be linked to invoice costing.

In summary, our overall recommendation is for The City to implement a comprehensive strategy and work plan to address accounting and reporting matters related to TCA to fully address TCA accounting matters with finality within the next fiscal year.

This comprehensive strategy and work plan would be in the nature of a thorough re-review and re-assessment at the business unit level of current policies, processes, internal controls and systems which support the accounting and reporting of TCA. Communication between the business units in terms of timing, review and deadlines should be included in the comprehensive strategy and work plan to properly integrate timely review for capital projects that are transferred between business units. With the benefit of experience obtained over the prior years, we recommend that this review would also consider the focus, emphasis and resources applied by business unit leaders toward the accounting for TCA. Following this review, we expect that The City would implement revised policies, processes, internal controls and systems designed to prevent or minimize errors within TCA balances.

Administration's Response (June 2014)

Administration agrees with this recommendation. A comprehensive strategy and work plan is currently in progress which would include reviewing at the business unit level of current policies, processes, internal controls and systems which support the accounting and reporting of TCA.

In relation to review of capital project costs and reconciliation, Administration is in the process of the development of the Corporate Project Management Framework that will develop Corporate Project Management policies, guidelines or tools regarding capital projecting monitoring. The current Corporate TCA policy also provides general guidelines on frequency of capital work in progress projects analysis. Currently, each business unit has informal processes in relation to review of capital project costs and reconciliation as a result of the nature of each business unit. However, a formalized process on review of capital project costs and reconciliation will need to be assessed as part of the comprehensive strategy.

Similar to the above, the current TCA policy provides general guidance on "hand-off" packages. Due to the nature of capital projects and the various business units involved, informal processes have been developed. However, a formalized timing and process of "hand off" packages will need to be assessed as part of the comprehensive strategy.

As a result of continued usage and refinement of capital asset accounting and management systems, certain business units may link to asset management systems. Understanding the benefit of TCA linked to invoice costing, this will be assessed by Administration subsequent to the completion of the comprehensive strategy. Currently, one of the business units that linked to asset management systems during 2013 has been discontinued beginning 2014. The majority of the business units are linked to actual expenditure.

Completion Timeline / Responsible Individual

The comprehensive plan and implementation will begin in 2014. Further actions and implementation will occur during 2015 / Corporate TCA with the above mentioned business units.

Administration's Response (January 2015)

During 2014, Administration has set up a TCA Project team led by an appointed TCA Project Manager to develop a comprehensive strategy and work plan. A TCA Project Charter has been developed and approved by the new TCA Steering Committee composed of the Chief Financial Officer and four General Managers. The TCA Project is well underway and the first item of focus is the simplification of Machinery & Equipment in developing procedures to ensure consistency across the organization.

Further progress will be made on assessing buildings and engineered structures into 2015 as part of the comprehensive strategy and work plan.

Auditor's response (based on November 2014 interim audit procedures)

We held discussions with Administration during the year and understand that Administration has commenced a comprehensive review of the various areas of TCA which includes a TCA Project Charter. The focus is currently on simplifying the process used to componentize machinery and equipment that affects multiple business units. As Administration continues the implementation into fiscal 2015, we will incorporate relevant audit procedures to determine that our recommendations are being addressed.

We will perform internal control and substantive procedures on a test basis on the various TCA areas during our year-end field work and will report any significant deficiencies or errors to Administration and the Audit Committee upon completion of the financial statement audit for 2014.

1.b. Training relating to TCA

Observation / Implication

Based on prior year audits, we understand that training on TCA matters has been provided to relevant business unit personnel. Based on our current year testing, we observed that there could be improvements relating to the training and communication of TCA policies and procedures for key finance personnel who are involved with TCA accounting and reporting:

- At times, TCA training sessions scheduled by the corporate finance reporting group are scheduled during peak busy times for the business units and are not mandatory, possibly resulting in low attendance by business unit personnel;
- Project managers responsible for preparing schedules of expenditures do not always have the in-depth knowledge required to appropriately categorize expenditures as TCA or non-TCA;
- A significant amount of TCA accounting in certain business units is reliant upon the timely and accurate transition of TCA projects between business units (e.g. Transportation Infrastructure and Roads). The detailed steps and purpose of the steps within this process may not be well understood on both sides of the transaction resulting in errors and delays in obtaining information; and
- TCA processes and documentation are complex and require multiple steps resulting in potential risk if key personnel within business units change roles. Often, a replacement individual, who must pick up new responsibilities, may not be familiar with the detailed TCA reporting processes which can result in errors in TCA reporting.

Recommendation

In order to ensure that there are consistent policies throughout The City and that key personnel in the TCA process have the appropriate knowledge of TCA policies and procedures, we recommend the following be considered by business units in conjunction with the corporate finance group in relation to training:

- Schedule training sessions multiple times throughout the year to be flexible with business unit schedules and increase attendance;
- Encourage or provide a mechanism (for example, regular meetings) for cross-sharing of information between business units so best practices and lessons learned are communicated throughout the business units;
- Increase technical TCA training for operations personnel and project managers responsible for categorizing TCA expenditures and identification of TCA at the project level; and
- Simplify TCA processes into overall flow charts and step by step guidance so that new personnel can easily and accurately pick up TCA reporting responsibilities.

Administration's Response (June 2014)

Administration agrees with this recommendation. To ensure consistent policies throughout The City and that key personnel in the TCA process have the appropriate knowledge of TCA policies and procedures, the following will be considered in relation to training:

- Finance training sessions are being planned with materials being developed that are easily accessible on The City's intranet that can be referred to. Training sessions will be considered throughout the year identifying key personnel for mandatory attendance;
- Emphasis will be placed on the encouragement of cross sharing information. A Community of Best Practice will need to be formally implemented to provide an opportunity for Finance and Operations to cross share information between business units and lessons learned;
- There has been general TCA training for operations personnel including self-learning TCA Fundamentals 101 and 102. Corporate TCA will work with business units to include the appropriate personnel for technical TCA training; and
- The TCA process overall flow chart will be considered as part of the comprehensive strategy.

Completion Timeline / Responsible Individual

Quarter 4, 2014 / Corporate TCA

Administration's Response (January 2015)

Administration has conducted training sessions throughout the year with the identified key personnel for mandatory attendance in Finance and Operations. Materials for the training session have been made easily accessible.

As part of the TCA Project, Administration is in the process of developing TCA Corporate Processes as part of the comprehensive strategy.

Auditor's response (based on November 2014 interim audit procedures)

We will perform internal control and substantive procedures on a test basis on the various areas during our year-end field work and will report any significant deficiencies or errors to Administration and the Audit Committee upon completion of the financial statement audit for 2014.

We will also hold discussions with Administration and various business units to determine the accessibility of the training materials and determine if all relevant key personnel have been provided this training. In addition, we will review the training materials to determine if key TCA topics have been addressed.

1.c. Capitalization of feasibility studies

Observation / Implication

During our audit procedures on the TCA prior year errors for the Water business unit, we observed that feasibility studies were being capitalized as work in progress prior to concluding on the actual feasibility of the project. In the subsequent year, the costs of feasibility studies related to projects that were determined not to be feasible were adjusted by restating the costs as an expense. This process results in unnecessary prior period errors in the recording of TCA.

Recommendation

In order to ensure that capitalization of TCA projects is appropriately and consistently applied we recommend:

- An assessment of the policy within all business units on the capitalization of feasibility studies to ensure it is consistent across business units and in accordance with Section 3150. For the most appropriate and conservative approach, it is recommended that costs on a project are not capitalized until the project is determined to be feasible and therefore, feasibility study costs on projects would not be capitalized;
- The new policy be communicated and incorporated into the general TCA guidelines to all business units; and
- Appropriate procedures and checklists be incorporated within the TCA policies to provide business units with the ability to identify feasibility studies performed in the year and determine the appropriate accounting of these costs.

Administration's Response (June 2014)

Administration partially agrees with this recommendation. An assessment of the policy within all business units is currently in process in determining the consistent application of capitalizing feasibility studies. As part of this assessment, this is to ensure all business units have applied accounting for feasibility studies in accordance with section 3150.

Based on the results of the assessment, Administration will then communicate any changes or clarification required in the general TCA guidelines as appropriate.

Completion Timeline / Responsible Individual

Quarter 3 2014 / Corporate TCA

Administration's Response (January 2015)

Administration has accessed and communicated that the cost of all feasibility studies expenses are to be considered TCA expenditures and recorded as work in progress ("WIP"). If and when a decision is made that the project will not go ahead, the feasibility studies expense will be removed from WIP and expensed in the year the decision is made.

Auditor's response (based on November 2014 interim audit procedures)

We will perform internal control and substantive procedures on a test basis on the various areas during our year-end field work and will report any significant deficiencies or errors to Administration and the Audit Committee upon completion of the financial statement audit for 2014.

2. PeopleSoft – removal of terminated employees

Observation / Implication

During payroll control testing, we observed that terminated employees were not removed from the system in a timely manner and, in certain cases, continued to be paid following the date of termination beyond regular vacation or standard pay that would be owing to the employee. We extended our testing to test 25 additional employee samples and noted that 13 out of the 25 employees were not removed from the system on a timely basis. We understand that the employees had full access to The City's internal systems. We, however, expanded our testing and noted that none of these 13 employees had logged onto the system since their termination. Of the 13 employees not removed on a timely basis, 4 continued to be paid by The City, however, the overpayments were eventually refunded by these employees.

This issue arose from delays in notification of the terminations by the business units to Human Resources as the formal departure form was not completed and forwarded to Human Resources. We understand that there is no formal policy currently in place which requires business units to inform Human Resources of employee terminations within a specified time period. We also observed that there is a control in place whereby Human Resources performs spot checks of terminated employees to ensure they are appropriately removed from the system. However, since this is only completed on a sample basis by Human Resources, all exceptions were not identified through this control.

Recommendation

We recommend that all business unit supervisors follow The City policy to inform Human Resources of terminated employees on a timely basis. The City should communicate to the business units what they deem to be an acceptable time frame for notification of termination to the Human Resources department. We also recommend that Human Resources perform a check of all employees within approximately two weeks of termination, to ensure timely removal of the employee from the system and discontinuation of pay.

Administration's Response (June 2014)

Administration agrees with this recommendation. Human Resources will remind Business Units of their responsibility to terminate employees in a timely manner and the consequences of not doing so through internal communication notices in Take 5 (semi-annual). System generated reports will be reviewed on a bi-weekly basis to validate that time and or schedules have been removed from the payroll system for terminated employees.

Completion Timeline / Responsible Individual

Pay Services will schedule a Take 5 reminder for Department ID owners, which is currently being drafted. This information will be communicated in June and December (semi-annual).

Pay administrators will review reports to ensure that all terminating employees are processed on a timely basis and that future schedules are removed. This is included in bi-weekly pay processing.

Administration's Response (January 2015)

Administration has sent out the Take 5 communications to Department ID Owners twice in 2014 (September and December). Additional 2015 communication has been scheduled for June 2015 and December 2015. Employee action reports are reviewed by pay administrators on a bi-weekly basis to ensure all terminated employees have scheduled time removed from the payroll system. In addition, monthly audits (random) are performed by Training, Audit and Documentation specialist in the work area to ensure the pay administrators are performing this task.

Auditor's response (based on November 2014 interim audit procedures)

Deloitte viewed the December 2014 Take 5 communication to Department ID Owners. During our year-end audit procedures, we will obtain a listing from Administration of all terminated employees during the year. From that listing, we will sample a selection of these terminated employees to verify that they have been removed from PeopleSoft in a timely manner. In addition, we will also test that compensation was not remitted to these individuals subsequent to their termination date. Finally, we will review a selection of Administration's bi-weekly and monthly audits to ensure that the controls noted above have been designed and implemented adequately.

3. Item presented in camera

Appendix B - December 31, 2012 Year End Observations

1. Capital Projects Monitoring

Observation / Impact

During the year, The City enters into a significant amount of capital projects. It is important that the status of these projects, for example, completed or work-in-progress, be monitored to ensure these projects are appropriately accounted for in the financial statements. During our testing of controls relating to capital projects, we observed that in some cases business units rely on the following methods to determine the status of ongoing projects:

- Verbal discussions with project managers; and
- Budget versus actual cost analysis.

There is a risk that status changes of on-going projects may not be appropriately communicated to business units and appropriately assessed by year-end at which time The City is in the process of finalizing its financial statements for the fiscal year. Furthermore, in cases where project status is discussed verbally, there is a risk that employee turnover could result in lost information if the project status is not documented through a formal, systematic process. This could result in incorrect recognition of tangible capital asset (“TCA”) balances, resulting in under-depreciation if projects have not been transferred from work-in-progress to completed TCA.

Recommendation

We understand that Administration is currently developing a process to monitor the status changes of on-going capital projects. This will allow business units to ensure that work-in-progress balances are appropriately accounted for at year-end. We recommend that business units maintain a listing of on-going projects with anticipated completion dates and ensure the projects are monitored throughout the year in the event that the project is completed and needs to be capitalized as TCA. Furthermore, it is recommended this listing be reviewed periodically and the project status be formally documented. This will result in a systematic and formal process to monitor capital projects, minimizing any risk of incorrect assessment of capital projects.

Administration’s response (June 2014)

Administration agrees with the recommendation. Administration will continue to develop a process during 2013 that will create a list of on-going projects with anticipated completion dates to ensure that the projects are monitored throughout the year in the event that the project is completed and needs to be capitalized as TCA. This process will take into consideration to review the project listing periodically and having the project status formally documented.

In addition, Administration is in progress in the development of the Corporate Project Management Framework that will develop Corporate Project Management policies, guidelines or tools regarding capital projecting monitoring.

Auditor’s response (based on November 2013 interim audit procedures)

During year-end field work, we will perform substantive procedures on a test basis on on-going projects and completion dates. We will report any significant deficiencies to the Audit Committee upon the completion of the financial statement audit for 2013.

Auditor’s response (based on 2013 year-end audit procedures)

During our current year testing, including audit procedures applied to the test the 2012 restatement we note that this recommendation is still in progress. Refer to December 31, 2013 observation #1.

Recommendation is carried forward.

Administration’s Response (January 2015)

Please refer to Administration’s response December 31, 2013 observation #1.

Auditor’s response (based on November 2014 interim audit procedures)

Please refer to Auditor’s response December 31, 2013 observation #1.

2. Removal of Information Technology Access

Observation / Impact

The City employs, approximately over 10,000 employees. There are instances when user access needs to be removed or revised based on either employee departures or changes in roles and positions.

During our testing of access termination at the network and application level, we noted a number of instances where access was not disabled on a timely basis. While access is removed on a timely basis once Enterprise Support Systems (“ESS”) is notified of a change, the timeliness of the notification from Human Resources / Pay Services to ESS is an issue.

Lack of timely removal of access, in particular at the network level, increases the risk of unauthorized access and/or malicious activities.

We further note that this observation is consistent with observation #8 of our 2011 year end audit.

Administration’s response to the 2011 observation was as follows:

“Administration agrees with this recommendation. During 2012, ESS will work with Human Resources/Pay Services to discuss a change in process where accounts are inactivated sooner in the Active Directory, where an employee’s actual last worked day is significantly different than their last pay date due to retirement or carry-over vacation”

Recommendation

We continue to recommend that a procedure be implemented to alleviate the time delay noted between Human Resources / Pay Services and ESS.

Administration's response

Administration continues to agree with this recommendation. During 2012, ESS had worked with Human Resources / Pay Services to improve the process and alleviate the time delay between when an employee needs network and other system access changes made and when the change actually takes place in the system (i.e. employee termination). ESS and HR will continue to improve this process in 2013 in order to bring this time delay to an acceptable level.

Auditor's response (based on November 2013 interim audit procedures)

We will perform internal control and substantive procedures on a test basis on the various areas during our year-end field work and will report any significant deficiencies or errors to Administration and the Audit Committee upon completion of the financial statement audit for 2013.

Auditor's response (based on 2013 year end audit procedures)

Based on our 2013 audit procedures, we noted issues with regards to timely removal of information technology access and, as such, this matter has not been satisfactorily addressed.

Recommendation is carried forward.

Administrations response (June 2014)

Administration continues to agree with this recommendation. Process improvements continue to be made. A pilot project is currently underway to test a process change that will allow the system access shutdown (inactivation of an employee) to occur before final payments have been processed. If successful, this will eliminate the two week delay that exists with current pay processing impeding improved results.

Completion Timeline / Responsible Individual

Quarter 4, 2014 / HR – Pay Services

Administration's Response (January 2015)

Administration has implemented process changes for system access shutdown (inactivation of an employee) to occur before final payments have been processed. This has eliminated the two week delay that existed previously.

Auditor's response (based on November 2014 interim audit procedures)

We will perform internal control and substantive procedures on a test basis on the various areas during our year-end field work and will report any significant deficiencies or errors to Administration and the Audit Committee upon completion of the financial statement audit for 2014.