

January 12, 2022

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

Dear Ms. Male:

Following the completion of the December 31, 2020 audit of the consolidated financial statements of The City of Calgary ("The City"), we provided a letter of recommendations to Administration and the Audit Committee on June 15, 2021. This letter included new recommendations we identified during the fiscal 2020 audit. These matters were not significant or material in nature in the context of the December 31, 2020 financial statements taken as a whole and did not impact our ability to issue our audit report.

This letter provides an update to the letter presented on June 15, 2021, based on our interim audit procedures performed through to November 2021, including Administration's response. Please refer to "Auditor's Update January 2022" and "Administration's response January 2022" for specific details. 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 a third party who uses this communication.

We wish to express our appreciation for the courtesies and cooperation extended to our representatives 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

cc: The Audit Committee of The City of Calgary

Update to December 31, 2020 year-end observations

1. Communication between business units and Corporate Financial Reporting

Year Identified - 2020

Observation:

The City's financial reporting processes require significant effort, coordination and communication between the business units and Corporate Financial Reporting ("CFR"). We observed some isolated instances where communication within the business units, as well as between the business units and CFR was lacking in detailed instructions and/or did not occur on a timely basis. As a result, while these resulted in no material misstatements, there is an increased risk that transactions are not recorded consistently across the organization, which could result in potential misstatements in the consolidated financial statements.

This was evidenced by the following matters identified during our 2020 audit procedures:

- a. The City received significant government funding to use for incremental costs and to compensate forgone or reduced revenues resulting from the COVID-19 pandemic. Each business unit was directed by the Corporate Budget Office ("CBO") to calculate its incremental costs and forgone or reduced revenues resulting from the COVID-19 pandemic and submit the calculations to determine the total amount eligible to be recorded in 2020. Instructions with respect to the calculation method for determining the forgone or reduced revenues were not clearly communicated to the business units, which resulted in inconsistent calculations across business units. Additionally, the calculations that were submitted by the business units were not appropriately reviewed by the business unit compiling the calculations. While the amount calculated was determined to be within the appropriate range, there was potential for incorrect calculations to lead to errors in amounts recognized as revenues and deferred as capital deposits.
- b. The City opened three bank accounts and issued thirteen promissory notes in 2020 with significant balances as of December 31, 2020. These amounts were reflected in the financial statements appropriately, but the communication to Deloitte for the audit confirmation process was delayed. This resulted in significant delays in completion of these procedures due to processing times required by the banks to provide a response to the audit confirmation letters.
- c. The City identified certain immaterial aged amounts in Capital Deposits. As a result, CFR instructed the business unit to investigate the aged deposits and to determine whether it was appropriate to retain these deposits as liabilities. In some instances, the business units within Transportation concluded that no liability exists related to these deposits and associated amounts were recognized into revenues in 2020. However, Deloitte noted that the evaluation criteria used by each business unit in Transportation was unclear resulting in some instances where there was a lack of evidence to support the extinguishment of the liability and recognition of the revenues.

Recommendation:

We understand that The City currently has processes in place to ensure new, unique or material transactions are communicated to CFR by the business units on a periodic basis and are appropriately accounted for in the consolidated financial statements. Based on our observations from the 2020 year-end audit, some of those processes were not operating effectively during the year. As a result, we recommend the following:

- a. CFR should perform an annual review of its existing processes to identify potential gaps that could be strengthened and improved. We recommend that on a sampling basis, the business units perform steps to verify that information compiled by the business units is complete and accurate. By strengthening its existing processes, and building in more robust reviews, Administration should ensure appropriate and thorough reviews are taking place at the business unit level and can encourage appropriate and timely communication between all business units, CFR and other relevant stakeholders.
- b. For new, unique or material transactions that affect multiple business units, CFR should hold informational sessions with the Finance Leads and Finance Service Leads and provide clear guidance and instructions to ensure consistency of application of policies across all business units, and to ensure timely resolution of items that may impact the consolidated financial statements. With the upcoming implementation of new accounting standards, clear communication within the business units, as well as between the business units and CFR, will be essential to accurate preparation of the consolidated financial statements.

Administration's response:

It is important to note that there were no misstatements in the financial statements as a result of the above observations and Administration feels that adequate controls were in place to mitigate the observations noted above and the risk of misstatement, from Administrations perspective, as a result is low. CFR and the business units will continue to collaborate on an on-going basis to ensure information is shared on a timely basis and accurately assessed.

To strengthen overall communications throughout The City, the following actions will be considered:

- a. CFR will work with CBO to provide clear guidance and instructions to Finance personnel when requiring business units to compile financial information in accordance with funding criteria. CFR will work with CBO on review standards when compiling data for the consolidated financial statements.
- b. Administration recognizes and agrees that regular communication is important to ensure that Administration is aware of financial reporting changes and impacts. As a result, the CFR team will continue to facilitate communication between business units and corporate functions including timely communication with Deloitte:
 - The CFR team will continue to meet with business units and corporate functions in May, September and December 2021 to discuss operational and financial changes as required.
 - The CFR team will continue to provide information sessions and updates on a regular basis to business units throughout the year to ensure that business units are aware of how accounting policies and standards should be consistently applied by all business units.
- c. CFR will meet throughout 2021 to discuss the investigation of the aged Capital Deposits and the evaluation criteria being used by each business unit. In these meetings, CFR will review and advise on the evaluation criteria used by each business unit and make recommendations to help business units understand how to consistently apply and support their determination criteria.

Administration's update – January 2022:

- a. Throughout 2021, there has been no new funding received that required CFR and CBO to work together to distribute guidance and instructions to Finance personnel. Administration will continue to monitor for when new out of the ordinary funding is received and will work with CBO on review standards when compiling data for the consolidated financial statements.

- b. Administration continues to recognize and agree that regular communication is important to ensure that Administration is aware of financial reporting changes and impacts. As a result, the CFR team continued to facilitate communication between business units and corporate functions:
 - CFR met with the business units in May, September and December 2021 to discuss operational and financial changes. This communication included instructions on periodic templates and accounting standard updates.
 - CFR updated the September Periodic Checklist and December Year-end Checklist to ensure that the business units are communicating new borrowings and bank accounts to the Treasury team and that CFR is aware of the addition.
 - Throughout the year, CFR provided information and accounting guidance on areas of focus including operating commitments, capital deposits and the organization realignment.
- c. During 2020, Administration took on an extensive process around capital deposits which continues into 2021. In 2020, this process consisted of each department providing an overview of their revenue recognition process and the reviews and controls in place to review capital deposit balances. In 2021, the Transportation business unit reviewed their aged capital deposit balances and ensured they were applied consistently with the recognition criteria. Administration further coordinated with all the departments on the Capital Deposit process. This process outlines the procedures to fill out the capital deposit templates and information on each of the capital deposit accounts and what they are used for. The completed document was provided during the September update to the business units. In addition, CFR created a quick reference guide that goes through the Public Sector Accounting Standards on recognition of capital deposits and the recognition into revenue. This quick reference guide has been added to the capital deposit template for business units to have on hand and was presented to the business units during the year end update.

Auditor's update - January 2022 (based on November 2021 interim audit procedures):

We held discussions with Administration to obtain an understanding of changes to processes and we assessed relevant controls for design and implementations in fiscal 2021 to address our above noted recommendations.

Through procedures performed, the following has been noted for recommendation 'a':

- a. CFR updated the periodic reporting checklist requiring business units to indicate whether new bank accounts have been opened or new debt or promissory note agreements have been entered into. We reviewed the September 2021 checklist and confirmed this was implemented as part of our assessment of design and evaluation of controls.
- b. CFR held regular meetings in May, September, and December 2021 with business units to ensure information is being compiled and reviewed appropriately and on a timely basis. We reviewed the meeting materials and confirmed that the communications included instructions on timely completion of periodic templates as well as a discussion over accounting standard updates impacting the business units. Specifically, CFR held a meeting on December 13, 2021 to communicate the appropriate recognition criteria for capital deposits to the business units. We obtained the capital deposit reference guide which was discussed during the meeting and confirmed it explicitly covers recognition criteria in addition to recommendations to assist Business Units to consistently apply the criteria and support their assessments.
- c. In September 2021, CFR provided business units with an email sign-off template to verify that financial information compiled by business units is complete and accurate. The sign-off template identifies who within the business unit has reviewed the information and ensures that an appropriate and timely review has occurred. We viewed the September 2021 template and confirmed the above details.

Further, based on our discussion with CFR, the following updates have been noted for recommendation 'b':

- a. During the November interim, CFR confirmed that there have been no instances of new funding received which require all business units to compile financial information in accordance with funding criteria. This was substantiated through our November interim audit procedures. We will obtain an update from CFR during our year-end field work.
- b. Based on discussions with Administration, CFR held periodic meetings (May 26 and 27 as well as September 21 and 23) with the business unit finance leads to discuss operational and financial changes for fiscal 2021. We obtained the meeting materials and attendance records for the 2021 sessions and confirmed that new, unique and material transactions affecting multiple business units were discussed. The session materials included guidance and information on the upcoming new accounting standards, new operating commitments, updates to the capital deposit schedules and re-alignment.
- c. CFR has updated the periodic reporting checklist effective September 2021 requiring business units to indicate whether new bank accounts have been opened or any new debt or promissory note agreements have been entered. We have reviewed the September 2021 checklist and confirmed this was implemented as part of our assessment of design and evaluation of controls.

Based on our procedures performed, all recommendations have been satisfactorily addressed.

2. Automation of the consolidation process

Year Identified - 2020

Observation:

As noted in a previous recommendation letter for the 2015 year-end audit, The City's consolidation process continues to be a manual exercise. The consolidated financial statements include figures from All Funds Statements ("AFS") and consolidation and elimination entries relating to four funds (operating, capital, tangible capital asset and reserve funds) and the related authorities.

Over the last number of years, the transactions between The City and the related authorities have become increasingly more complex, resulting in additional consolidation and elimination entries. The complexity of transactions will continue to increase in the coming years with the implementation of new accounting standards by The City and the related authorities.

Administration uses excel spreadsheets to prepare The City's consolidated financial statements, which include the AFS's from the ten related authorities and approximately one hundred elimination and consolidation entries, resulting in a complex consolidation exercise. The use of spreadsheets for a complex consolidation is not a best practice as the use of spreadsheets inherently increases the risk of errors relating to incorrect formulas, calculations or simple human error (unintentional deletion or incorrect data entry) and data integrity issues that may go undetected by the preparer or reviewer. Further, reflecting changes from updates to the AFS reports prepared by the related authorities is a manual process that is prone to potential errors and integrity issues.

Additionally, The City undergoes internal reorganizations from time to time. These internal reorganizations may require changes to the disclosures in the consolidated financial statements, including comparative information. To the extent that the consolidation can become more automated, there is a likelihood that generation of supplementary notes and schedules such as segmented disclosures could be done on a timelier basis while freeing up resourcing for Administration to focus on tasks that require manual involvement.

Recommendation:

We recommend that Administration implement an automated process relating to the preparation of the consolidated financial statements. For example, a dedicated consolidation information technology software should be utilized (i.e. SAP, Hyperion, PeopleSoft) to minimize errors, integrity issues, generate useful reports, and to increase efficiency and timeliness of the financial reporting process.

Administration response:

Administration agrees with this recommendation. Currently, there are appropriate internal controls in place to prepare an accurate and complete consolidation; however, CFR will review the current consolidation process in 2021 for additional improvements and consider the available options for the implementation of an automated process for the future. CFR recognizes that given the nature and size of The City, including its related authorities, an automated process for the consolidation would result in the generation of useful reports, increased efficiencies and timeliness of the financial reporting process, and reduce the risk profile of the current manual process. Implementation of a consolidation system is a multi-million dollar commitment by The City and would require capital prioritization in competition with many other high-priority initiatives with benefits primarily qualitative in nature. CFR will prepare a business case by the end of fiscal 2021 and engage with internal IT resources for scope and cost considerations. Dependent on these findings, CFR may submit an application for funding in the next four year budget cycle.

Administration's update – January 2022:

Administration continues to agree with this recommendation. Implementation of a consolidation system is a multi-million dollar commitment by The City and requires capital prioritization in competition with many other high-priority initiatives with benefits primarily qualitative in nature. Administration has prepared a business case during 2021 and will engage with internal IT resources for scope and cost considerations during fiscal 2022. Dependent on these findings, CFR may submit an application for funding in the next four year budget cycle.

Auditor's update - January 2022 (based on November 2021 interim audit procedures):

We will continue to obtain updates from Administration on the progression of the business case for an automated consolidation process. During our year-end fieldwork, we will perform our planned audit procedures on the consolidation and will report any deficiencies or further recommendations to Administration and Audit Committee upon the completion of the 2021 year-end audit.