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June 10, 2014

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

Dear Mr. Sawyer:

We have recently completed our audit of the consolidated financial statements of The City of Calgary ("The City") for the year ended December 31, 2013. During the course of our December 31, 2013 audit, 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 financial statements taken as a whole and did not impact our ability to issue our audit report.

The accompanying appendices also include an update to matters identified during our fiscal 2012, 2011 and 2009 year end audits. Those observations that were appropriately addressed during our last update provided on January 24, 2014 have been formally removed from this letter, including fiscal 2010 observations which have all been satisfactorily addressed.

The objective of a financial statement audit conducted in accordance with Canadian generally accepted auditing standards ("Canadian GAAS") is to express an opinion on the fairness of the presentation in all material respects of The City's financial statements for the year ended December 31, 2013 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 financial statement audit 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 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.

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 risks 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 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 audit should not be relied upon to identify all significant deficiencies. A significant deficiency is defined in the Canadian Auditing Standards 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 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,

Deloitte LLP

Chartered Accountants

cc: The Audit Committee of The City of Calgary

# 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.

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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 noncompliance 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**
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 system during 2013 has been discontinued beginning 2014. 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.

### 1.b. <u>Training relating to TCA</u>

**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**

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.
- The TCA process overall flow chart will be considered as part of the comprehensive strategy.

**Completion Timeline / Responsible Individual**

Quarter 4, 2014 / Corporate TCA

**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**

Administration partially agrees with this recommendation. An assessment of the policy within all business units are 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

## 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 to 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**

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 biweekly pay processing.

## 3. Item presented in camera

# Appendix A - December 31, 2012 Year End Observations

## 1) Review of internally prepared schedules

**Observation / Impact**
During The City's day-to-day operations, various schedules and supporting documents are prepared. A secondary review of these schedules and supporting documents is important to ensure both the accuracy and validity of information which ultimately gets incorporated into the financial statements. Such secondary review is usually evident by a sign off or an initial by the reviewer.

During the course of the audit, we observed instances in a number of business units where there appears to be a lack of formal review and in some instances evidence of review of schedules and supporting documents. This observation was evident in our current year testing in both the operations and finance areas.

We also noted errors in the 2012 commitments schedules relating solely to financial statement disclosures which were subsequently corrected by Administration prior to the finalization of the financial statements. We understand that the 2012 commitments schedules had been through a secondary review, however, perhaps a more thorough and detailed review would allow for the identification of errors. We further note that the current year observation is consistent with observation # 5 of our 2010 and 2009 year end audits.

**Recommendation**
A lack of review of schedules and supporting documentation for completeness and accuracy can result in valuation and recording errors which can materially misstate the financial statements. Further a formal lack of evidence of review can delay the identification of significant issues which may impact The City's operations.

We continue to recommend that Administration emphasize the importance to the business units of a thorough and documented review of all schedules and supporting documentation prior to finalization and recording entries in the system. Further, those individuals responsible for review should indicate their evidence of review through a formal sign off.

**Administration's response**
Administration continues to agree with this recommendation. Administration noted that there have been improvements on the evidence of review of schedules and supporting documentation. Where there are instances that there is lack of evidence of review, there are mitigating controls of the review of information. Administration will continue to provide guidance for review and signoff in periodic and year end checklists, emphasized in all training sessions and recommended to be embedded within processes throughout The City. The City will continue to emphasize the importance and to provide evidence of review and signoff in a timely manner.

For the 2012 year end, Administration has provided enhanced guidance as well as templates for business units to use in their preparation of operating and capital commitment schedules. In the future Administration will continue to emphasize the importance of thorough review of the schedules against source evidence. Administration will also conduct best practices training sessions with the business units and will discuss topics such as proper review of schedules, back up evidence review and use of the prepared templates to ensure templates are accurately used for capital and operating commitments.

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

We will test the design and implementation of internal controls relating to review of schedules and perform substantive procedures on a test basis during year-end field work. 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)**
Based on our audit procedures performed during the current year, we noted that internally prepared schedules at the business unit level were appropriately signed off by both a preparer and reviewer.

Recommendation has been satisfactorily addressed.

## 2) 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 ongoing 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**
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.

**Administrations response**
Please refer to Administration's response December 31, 2013 observation #1.

## 3) User Access – Expenditure Cycle – Segregation of Duties

**Observation / Impact**
During our testing of the expenditure cycle, we observed a segregation of duties matter where one employee has access to modify the master vendor listing, also has access to various accounts payable posting and processing roles as well as access to blank cheque stock. In an extreme case, this lack of segregation of duties could result in inappropriate behavior.

We applied certain procedures to test reports extracted from PeopleSoft and based on our limited testing, we did not observe any issues with regards to the creation or modification of vendors. However, it is recommended that this employee's access to modify vendor listings be removed, especially in light of all other duties and responsibilities this individual has.

**Recommendation**
We recommend that The City periodically review the level of authority that employees have within PeopleSoft to alleviate any risk of unauthorized or inappropriate activities.

**Administration's response**
Administration agrees with this recommendation. Accounts payable has implemented segregation of duties for the Team Lead of Payment & Expense by removing vendor access effective immediately. The Leader of Corporate Accounts Payable will continue to include in the 2013 work activities schedule to conduct a periodic review (at least annually) of the level of authority that employees have within PeopleSoft as the system upgrade is now effective in 2013.

**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)**
During our current year testing, we tested the expenditure cycle and related controls and noted no issues relating to segregation of duties.

Recommendation has been satisfactorily addressed.

## 4) Removal of Information Technology Access

**Observation / Impact**
The City employs, approximately over 10,000 employees. There are instances when user access needs to 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**

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

## 5) Evidence of Information Technology Information Security Controls

**Observation / Impact**
While we noted that formal Information Technology security management processes are in place, our testing noted instances where a sufficient audit trail was not maintained to provide support for the following areas:

1) Evidence of daily UNIX access review was not retained;
2) Database access is logged but not reviewed; and
3) Active Directory changes are logged but not reviewed.

We further note that the current year observation is consistent with observation #9 of our 2011 year end audit.

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

*"Administration agrees with this recommendation. During 2012, PeopleSoft - Enterprise Support Systems will work with our Business Users to develop a process and related documentation to regularly review and validate PeopleSoft user access".*

**Recommendation**
We continue to recommend that documented evidence should be retained to support the evidence of occurrence of these controls.

**Administration's response**
Administration continues to agree with this recommendation overall. Administration found that many log reviews are completed however the documentation supporting the evidence of review has not been stored in a manner that is easy to review.

To ensure that future logs are easily accessible and auditable, IT and ESS will work on developing standard documentation and storage areas to support the required logging and record of reviews.

**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, including testing of IT controls, we note that all matters noted above have been satisfactorily addressed.

Recommendation has been satisfactorily addressed.

# Appendix B – December 31, 2011 Year End Observations

| Observation/Recommendation | Auditor's Update (based on 2012 year end audit procedures) | Administration's update |
|---|---|---|
| **Tangible Capital Assets: Budgeting for Amortization**<br><br>**Observation / Impact**<br>Business Units do not presently budget for tangible capital asset amortization.<br>**Recommendation**<br>We understand Administration is considering processes that would enable business units to budget for depreciation. This will allow the business units to take ownership of the full cycle financial reporting objectives and enable more effective capital asset management deployment and efficiency. We recommend that Administration consider integrating amortization into the budgeting process. | As this recommendation will be considered for implementation during the next budget cycle, no further action is required on the part of Administration during the 2012 audit. We will carry this recommendation forward and provide an update to the Audit Committee once the recommendation has been implemented, which is expected during the next budget cycle. | Administration agrees with this recommendation. The Municipal Finance Clarification Regulation (Alberta Regulation 191/2010) allows municipalities to choose to adopt an annual budget in a format that is consistent with its financial statements or to adopt an annual budget that excludes amortization other than the amortization for public utilities. The City of Calgary is in full compliance by choosing to report on the latter basis. Administration agrees that in the fullness of time and transition to the full accrual local reporting model, amortization should be provided for in the budget. In order to adopt this change, the budget processes must carefully consider the appropriate basis, policies and accountabilities regarding these amounts. This will be considered during the planning phase of the next four year budget cycle for 2015 – 2018. |
| **6) User Access – Expenditure Cycle** | Refer to Appendix A - December 31, 2012 year end audit observation #3. | Refer to Appendix A - December 31, 2012 year end audit observation #3. |
| **8) Removal of Information Technology Access** | Refer to Appendix A - December 31, 2012 year end audit observation #4. | Refer to Appendix A - December 31, 2012 year end audit observation #4. |
| **9) Evidence of Information Technology Information Security Controls** | Refer to Appendix A - December 31, 2012 year end audit observation #5. | Refer to Appendix A - December 31, 2012 year end audit observation #5. |

# Appendix C – December 31, 2009 Year End Observations

| Observation/Recommendation | Auditor's Update (based on 2013 year end audit procedures) | Administration's update |
|---|---|---|
| | | |
| **Approval of journal entries**<br>During the course of our audit, we noted that the formal approval process of significant, complex journal entries prepared and posted in the accounting system is not consistently applied. Although there is a high-level review of account reconciliations and financial statements that is designed to identify inappropriate journal entries, the evidence of a formal review and approval of some journal entries tested could not be provided. The lack of a formal review of journal entries could result in an increased risk that a journal entry could be entered into PeopleSoft that results in a financial statement misclassification and recording errors.<br>Incorrect journal entries may be recorded in PeopleSoft and errors in the accounting records may result.<br>**Recommendation**<br>We recommend that all significant, complex, manual journal entries be formally reviewed and approved by the appropriate Administration or Business Unit personnel prior to recording. Further, Administration should implement quantitative and qualitative thresholds for approval of the respective journal entries. The accounting software is embedded with an electronic approval feature that is currently being underutilized. Further, the approval process should be performed closer to the point of initiation of transactions such that errors or irregularities can be identified and validated in a timely manner. | We performed audit testing on a sample of journal entries and observed that Administration has implemented a review of journal entries for high risk transactions during 2013.<br>Recommendation has been satisfactorily addressed. | Not required |