Deloitte.

January 15, 2014

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, 2012 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 20, 2013. These matters were not significant or material in nature in the context of the December 31, 2012 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 in November 2013.

Furthermore, we have also provided an update to our recommendations identified during the December 31, 2011, December 31, 2010 and December 31, 2009 audits within Appendices A to C. Our update is based on procedures we performed during the 2012 year end audit.

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, 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.

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.

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.

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.

Auditors'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.

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.

Auditors'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.

Appendix A – December 31, 2011 Year End Observations

1) Communication between Business Units

Satisfactory implementation of recommendation during our last update provided on January 24, 2013. Recommendation has been formally removed from management letter.

2) Pension Liability

Satisfactory implementation of recommendation during our last update provided on June 20, 2013. Recommendation has been formally removed from management letter.

3) Multi-Employer Pension Plan

Satisfactory implementation of recommendation during our last update provided on June 20, 2013. Recommendation has been formally removed from management letter.

4) Tangible Capital Assets

a) Recording of Assets at Negative Book Values
Satisfactory implementation of recommendation during our last update provided on January 24, 2013. Recommendation has been formally removed from the management letter.

b) Impairment Testing of Tangible Capital Assets
Satisfactory implementation of recommendation during our last update provided on January 24, 2013. Recommendation has been formally removed from the management letter.

c) Budgeting for amortization

Observation / Impact
Business Units do not presently budget for tangible capital asset amortization.

Recommendation
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.

Administration's response
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

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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.

Auditor's response (based on November 2012 interim audit procedures)
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.

5) **Landfill Liability**

Satisfactory implementation of recommendation during our last update provided on June 20, 2013. Recommendation has been formally removed from management letter.

6) **User Access – Expenditure Cycle**

Refer to December 31, 2012 year end audit observation #3.

Information technology observations

7) **Segregation of Duties Conflicts in PeopleSoft (TCA Module)**

Satisfactory implementation of recommendation during our last update provided on June 20, 2013. Recommendation has been formally removed from management letter.

8) **Removal of Information Technology Access**

Refer to December 31, 2012 year end audit observation #4.

9) **Evidence of Information Technology Information Security Controls**

Refer to December 31, 2012 year end audit observation #5.

Appendix B – December 31, 2010 Year End Observations

Observation/Recommendation	Auditor's Update (based on 2012 year end audit procedures)	Administration's update
Recommendations for the following December 31, 2010 year end observations were satisfactorily implemented during our last update provided on January 24, 2013 and June 20, 3013. As such the recommendation has been formally removed from the management letter. 1) **a. Donated assets** 1) **b. Documentation on capital costs that are not capitalized TCA** 1) **c. TCA disposals** 2) **Cash accounting procedures** 3) **Bond amortization for money market fund** 4) **Financial Statement consolidation - intercompany transactions**		
5) Review of internally prepared schedules	Refer to December 31, 2012 observation #1.	Refer to Administration's response under December 31, 2012 observation #1.

Appendix C – December 31, 2009 Year End Observations

Observation/Recommendation	Auditor's Update (based on 2012 year end audit procedures)	Administration's update
Recommendations for the following December 31, 2009 year end observations were satisfactorily implemented during our last update provided on January 24, 2013 and June 20, 2013. As such the recommendation has been formally removed from the management letter. 1) **a. Use of complex spreadsheets(specific to TCA)** 1) **b. Amortization of capital asset additions** 1) **c. Inappropriate capitalization of expenses** 1) **d. Review of internally prepared schedules** 1) **e. Asset valuation process** 1) **f. Asset Management System** 3) **Use of complex spreadsheets** 4) **Landfill liability calculation**		
2) Approval of journal entries 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. Incorrect journal entries may be recorded in PeopleSoft and errors in the accounting records may result. **Recommendation** 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	We performed audit testing on a sample of journal entries and noted that the formal approval of journal entries did not always occur. However, we also noted that journal entries are approved for TCA and payroll which are the two areas which generate the largest number of journal entries. We also did not note any issues or errors in the approval process in those areas where approvals are existent. Administration has implemented a review of journal entries for high risk transactions as part of the PeopleSoft upgrade that went live in 2013. We will continue to monitor this recommendation and update Administration and the Audit Committee following the completion of our year end audit	Administration continues to agree with this recommendation. For 2013, Administration has implemented a review of journal entries for high risk transactions as part of the PeopleSoft upgrade that went live in 2013.

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Observation/Recommendation	Auditor's Update (based on 2012 year end audit procedures)	Administration's update
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.	procedures for 2013.	
5) Disclosure of commitments	Refer to December 31, 2012 observation #1.	Refer to Administration's response under December 31, 2012 observation #1.