

**THIS IS AN EXTRACT FROM THE MINUTES OF THE PUBLIC MEETING OF THE
TORONTO POLICE SERVICES BOARD HELD ON SEPTEMBER 28, 2006**

#P279. CITY OF TORONTO AUDIT RESULTS – DECEMBER 31, 2005

The Board was in receipt of the following report August 21, 2006 from William Blair, Chief of Police:

Subject: City of Toronto Audit Results – December 31, 2005

Recommendations:

It is recommended that:

1. the Board receive the City of Toronto Audit Results – December 31, 2005 from Ernst and Young;
2. the Board forward this report to the City's Audit Committee advising the Committee that the Service has taken corrective action on the control deficiency identified by Ernst and Young; and
3. the Board request that, in future, the City Audit Committee forward the Letter of Recommendations pertaining to the Toronto Police Service directly to the Board for its consideration and appropriate action.

Background:

The *Municipal Act* requires that the City of Toronto prepare and publish annual financial statements that consolidate all of the operations for which the City is responsible. The consolidated financial statements include the operations of City departments, as well as agencies, boards and commissions, including the Toronto Police Service.

To ensure the financial statements have integrity and can be relied upon, they are audited by the City's external auditors Ernst & Young LLP. The financial statements must be prepared in accordance with the generally accepted accounting principles as set by the Canadian Institute of Chartered Accountants' (CICA) Public Sector Accounting Board (PSAB).

Comments:

The Ernst & Young auditors provide the City of Toronto Deputy City Manager and Chief Financial Officer with an audit results package containing the following key information:

- Additional information regarding the scope and results of the audit which will help the City Audit Committee perform its duties and responsibilities;
- Items of audit significance discussed with management;

- The dollar value of known and likely audit differences discovered during the audit. The values represent differences between the amounts recorded by management and what the auditors believe should have been recorded under generally accepted accounting principles;
- A Letter of Independence, whereby the auditors declare their independence from the organization and its financial statements; and
- A Letter of Recommendations, outlining perceived internal control deficiencies and recommendations for improving them.

The 2005 audit results package was presented to the City of Toronto Audit Committee at its meeting of June 15, 2006. The Audit Committee accepted and forwarded the audit results to City Council for its meeting of June 27 to 29, 2006.

Recommendation for the Toronto Police Service:

The Toronto Police Services Board is responsible for ensuring that management fulfills its financial reporting responsibilities. The financial results of the Service are consolidated and reported with the City of Toronto. The external auditors have provided an opinion on the statements as a whole. It is therefore important that the Board members see the complete results of the consolidated audit report, including the one recommendation directed at the Service.

The only recommendation addressed to the Toronto Police Service is provided on page 30 of the City of Toronto Audit Results – December 31, 2005. The recommendation relates to the need to maintain a central log of authorized user access for the PeopleSoft and TRMS systems in the Enterprise Resource Management Unit, Human Resources. In order to address this recommendation, a process and log have been created and are being maintained by the user administrator. This recommendation has therefore been implemented.

Conclusion:

It is recommended that the Board receive the City of Toronto Audit Results – December 31, 2005 package from Ernst and Young and advise the City Audit Committee that the external auditor's recommendation pertaining to the Toronto Police Service has been implemented. Finally, consistent with the Board's oversight role, it is recommended that the Board request the City Audit Committee to forward all future letters of recommendation directly to the Board for its consideration and appropriate action.

Mr. Tony Veneziano, Chief Administrative Officer, Administrative Command, and Ms. Diana Brouwer, Executive Director, Ernst & Young will be in attendance to answer any questions from the Board.

The Board approved the foregoing.

City of Toronto

Audit Results – December 31, 2005

Report to Audit Committee of the Council of the City of Toronto

 **ERNST & YOUNG**
Quality In Everything We Do

May 30, 2006

Members of the Audit Committee
of the Council of the City of Toronto

Dear Members of the Audit Committee:

We are pleased to present the results of our audit of the consolidated financial statements of the City of Toronto (the "City" or the "organization") and the status of our final procedures.

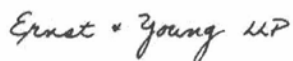
This report to the Audit Committee summarizes the terms of our engagement, the issues of audit significance discussed with management and provides the communications required by our professional standards.

Our audit was designed to express an opinion on the December 31, 2005 consolidated financial statements of the City. In planning the audit we held discussions with management, considered current and emerging business needs, along with an assessment of risks that could materially affect the consolidated financial statements and aligned our audit procedures accordingly. We received the full support and assistance of the City's personnel in conducting our audit.

This report is intended solely for the use of the Audit Committee, Council and management and is not intended to be and should not be used by anyone other than these specified parties. We disclaim any responsibility to any third party who may rely on it. Further, this report is a by-product of our audit of the December 31, 2005 consolidated financial statements and indicates matters identified during the course of our audit. Our audit did not necessarily identify all matters that may be of interest to the City in fulfilling its responsibilities.

We appreciate this opportunity to present the contents of this report with you and answer any questions you may have about these or any other audit-related matters.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Ernst & Young LLP'.

Martha Tory/Diana Brouwer /Kathi Lavoie
416-943-3678/905-882-3037/905-882-3056

Required Communications

Generally accepted auditing standards in Canada require the auditor to ensure that the committee of the Board having oversight responsibility for the financial reporting process receives additional information regarding the scope and results of the audit that may assist them in fulfilling their responsibilities.

| Area | Comments |
|---|---|
| <p>Auditors' Responsibilities Under Generally Accepted Auditing Standards (GAAS)</p> <p>As set out in the section on audit approach, we designed our audit to express an opinion on the City's consolidated financial statements.</p> <p>The financial statements are the responsibility of management. Our audit was designed in accordance with GAAS which provides for reasonable, rather than absolute, assurance that the consolidated financial statements are free from material misstatement.</p> <p>As a part of our audit, we obtained a sufficient understanding of the internal control structures to plan our audits and to determine the nature, timing and extent of testing performed.</p> | <p>We anticipate issuing an unqualified audit opinion dated May 5, 2006 for the City upon approval of the financial statements by the City of Toronto Council and completion of certain outstanding procedures. The following procedures are outstanding:</p> <ul style="list-style-type: none"> • Management representation letter; and • Various confirmations (legal, liability claims and bank) |
| <p>Changes to Audit Approach Outlined in Planning Document</p> <p>In our planning document, we indicated that we would conduct our audit in accordance with Canadian generally accepted auditing standards in order to deliver to you our final report on your 2005 consolidated financial statements. Our plan to you indicated that our strategy was to test and rely on controls in connection with City payroll, and City and Police purchases/disbursements accounting streams with substantive procedures covering the remainder of the accounts as the use of confirmations, detailed analytic procedures and specific testing of account balances is the more efficient approach for us to take in those areas.</p> | <p>There were no changes to the audit approach outlined in the planning document.</p> |
| <p>Adoption of, or Changes in, an Accounting Principle, Including Material Alternative Accounting Treatments Discussed with Management and Acceptability of a Particular Policy used by Management</p> <p>We determine that the Audit Committee is informed about the initial selection of, and any changes in, significant accounting principles or their application when the accounting principle or its application, including alternative methods of applying the accounting principle, has a material effect on the financial statements.</p> <p>In addition, we report to the Audit Committee all alternative accounting treatments within Canadian generally accepted accounting principles (GAAP) for policies and practices related to material items (including recognition, measurement, presentation and disclosure alternatives) that have been discussed with management during the current audit period including ramifications of the use of such alternative disclosures and treatments and the preferred treatment by us.</p> | <p>During the year, management adopted the new requirements for accounting for contingencies in accordance with Canadian generally accepted accounting principles. Refer to the discussion under "Items of Audit Significance Discussed with Management" within this package.</p> |

Required Communications

| Area | Comments |
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| <p>Sensitive Accounting Estimates and Disclosures</p> <p>The preparation of financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's current judgments.</p> <p>We determine that Audit Committee is informed about management's process for formulating particularly sensitive accounting estimates and disclosures and about the basis for our conclusions regarding the reasonableness of those estimates.</p> | <p>There are significant judgments and/or estimates required to prepare the financial statements where actual amounts may be significantly different from the estimates. We discuss the more significant accounting estimates further within the "Areas of Audit Emphasis and Items of Audit Significance Discussed with Management".</p> |
| <p>Major Issues Discussed with Management Including Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas</p> <p>We determine that Audit Committee is informed about the methods used to account for significant unusual transactions and the effects of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.</p> | <p>We are not aware of any significant unusual transactions recorded by the City or of any significant accounting policies used by the City related to controversial or emerging areas for which there is a lack of authoritative guidance.</p> |
| <p>Significant Audit Adjustments and Unadjusted Differences Considered by Management to be Immaterial</p> <p>We provide Audit Committee with information about adjustments arising from the audit (whether recorded or not) that could in our judgment either individually or in the aggregate have a significant effect on the City's financial statements.</p> <p>We inform Audit Committee about unadjusted audit differences accumulated by us during the current audit period and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the consolidated financial statements taken as a whole.</p> | <p>During the course of our audit, we accumulate differences between amounts recorded by the City and amounts that we believe are required to be recorded under generally accepted accounting principles. All accounting differences revealed by the audit were discussed with management to determine whether an adjustment should be recorded.</p> <p>Significant audit differences identified by us have been adjusted by management.</p> <p>There were no unrecorded audit adjustments that could, in our judgment, either individually or in the aggregate, have a significant impact on the consolidated financial statements.</p> <p>Management considered the unadjusted audit differences to be immaterial, both individually and in the aggregate to the consolidated financial statements as a whole. We concur with management's conclusion.</p> <p>Refer to "Summary of Audit Differences" section of this report.</p> |
| Disagreements with Management | None. |
| Serious Difficulties Encountered in Dealing with Management when Performing the Audit | None. |
| Material Weaknesses in Internal Controls | No material weaknesses in internal control were identified. |

Required Communications

| Area | Comments |
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| Fraud and Illegal Acts We report to Audit Committee fraud and illegal acts involving senior management and fraud and illegal acts (whether caused by senior management or other employees) that cause a material misstatement to the financial statements. | Our audit procedures include ongoing discussions with the Auditor General's Office on instances of fraud and our review of their annual report on fraud to the Audit Committee. We are not aware of any matters that require communication based on our audit procedures performed on the consolidated financial statements. |
| Consultation with Other Accountants | None of which we are aware. |
| Other Information in Documents Containing Audited Financial Statements | Once completed, we will review the Annual Report for consistency between the audited consolidated financial statements and other sections of the report. |
| Related Party Transactions Related party transactions identified by the auditor that are not in the normal course of operations or that involve significant judgments made by management concerning measurement or disclosure must be disclosed to the Audit Committee. | Significant related party amounts that are not eliminated for the Government Business Enterprises are disclosed within the notes to the financial statements. The significant disclosures are with respect to Toronto Hydro and Toronto Parking Authority. In addition, in 2005, there was a sale of street lights from the City to Toronto Hydro which is disclosed in Note 5 in the financial statements. See discussion within the "Areas of Audit Emphasis and Items of Audit Significance Discussed with Management" section. |
| Major Issues Discussed with Management in Connection with Initial or Recurring Retention | None. |
| Matters Relating to Component Entities of the Company When the financial statements of a company (primary entity) include financial information from financial statements of a component entity (a subsidiary, investee (other than a portfolio investment), or joint venture; or an entity whose financial information from financial statements is included with those of the primary entity), the auditor communicates with Audit Committee those matters relating to the component entities that in the auditor's judgment are of significance in the context of the primary entity (for example, weaknesses in systems of internal control that have resulted, or could result, in material errors in the primary entity's consolidated financial statements). | The consolidated financial statements of the City reflect the assets, liabilities, revenues and expenditures of the operating fund, capital fund, reserves and reserve funds of the City, and except for the government business enterprises which are accounted for on the modified equity basis of accounting, include all organizations that are accountable for the administration of their financial affairs and resources to City Council and are controlled by the City (as noted in note 1 to the consolidated financial statements). All audit differences identified upon performance of the individual audits of the component entities of the City have been discussed with management of that entity and communicated to the audit committee or board of that entity. Any audit differences identified in these entities that met our reporting threshold at the consolidated City level have been included in our detailed listing of unadjusted amounts (refer to "Summary of Audit Differences" section for details). We are not aware of any matters relating to those entities that could have a significant impact on the City's reporting. |

Required Communications

| Area | Comments | | | | |
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| Auditors' Independence Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between your organization and Ernst & Young LLP that, in our professional judgment, may reasonably be thought to bear on our independence. | Refer to "Independence Letter" section. | | | | |
| Other Audit and Non-Audit Services Provided to Your Organization | Audit services provided to the City are in accordance with the request for proposal. From time to time, we have been engaged to perform specified procedures on various subsidy reports prepared by the City; however, fees have been separately negotiated and separate purchase orders have been issued for these engagements. In addition, we were engaged by the City, in accordance with a separate request for proposal, for services with respect to examining the City's asset and liability accounts to identify potential commodity tax recoveries. | | | | |
| Fees | <table> <tr> <td data-bbox="894 499 1003 514">Audit (City-only)</td><td data-bbox="1230 499 1292 514">\$319,000</td></tr> <tr> <td data-bbox="894 531 1044 569">Commodity tax services recoveries</td><td data-bbox="1247 531 1354 546">16% of identified</td></tr> </table> <p>The above fee is in accordance with the City's request for proposal for audit services. The total annual audit fee for the entities listed in the RFP is \$750,000 per year inclusive of expenses and GST. Any additional fees billed for audit related services are disclosed in our reporting package to the other entities. In addition, there are additional fees in the year with respect to some special reports required for Ministry purposes. These special reports generally have a fee of approximately around \$7,500 per report.</p> | Audit (City-only) | \$319,000 | Commodity tax services recoveries | 16% of identified |
| Audit (City-only) | \$319,000 | | | | |
| Commodity tax services recoveries | 16% of identified | | | | |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

During the course of planning and executing our audit, the following items/matters of audit significance were discussed with management:

| Item | Description | Audit Results and Comments |
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| Liabilities, Contingent Liabilities and Contractual Obligations | <ul style="list-style-type: none"> The City is subject to various legal claims in the normal course of operations. The provisions of the new PSAB Handbook Sections on liabilities, contingent liabilities and contractual obligations require the recognition of contingent liabilities (except for loan guarantees) when an event is likely to occur and is reasonably estimable. The new Handbook Section may be applied retroactively or prospectively. Management decided to retroactively adopt the changes. Management has assessed the likelihood of its contingent liabilities occurring, and in those instances where a liability is likely to occur, management has reasonably estimated its liability. Management engaged the services of Mercer Oliver Wyman to assist in performing management's assessment of insurance related claims and drew upon the expertise of the City's internal Legal Services department in assessing non-insurance related claims. Where necessary, the City also enquired of external legal counsel. | <ul style="list-style-type: none"> Our audit procedures tested that all significant contingent liabilities of the City were included in managements' assessment and that managements' estimation process was reasonable. We concur with the accrual made and the information presented within the consolidated financial statements, including the disclosures in Notes 2 and 16 of the financial statements. As a result of performing our audit procedures on these amounts, we identified areas where management can strengthen controls and improve efficiencies within its current processes. See "Letter of Recommendations" section for further information. |
| Significant Accounting Estimates – Employee Benefit Costs | <ul style="list-style-type: none"> Future employee benefit costs represent a very significant unfunded liability within the City. During 2003, the City contracted the services of Mercer Human Resource Consulting to update the actuarial liability with respect to employee post employment and retirement benefit plans as of December 31, 2002 and projected forward for December 31, 2003 through to 2005. The City has used these projected results provided by Mercer as at December 31, 2005 in recording the future employee benefit liability | <ul style="list-style-type: none"> Our audit procedures included testing that new agreements negotiated with employees' unions were considered by Mercer in the projected results as at December 31, 2005. As a result of the updated valuation by Mercer's for the impact of the new union agreements, it was determined by Mercer's that the liability should increase by \$3,090,000. This adjustment has been included in the 2005 actuarial loss. Our procedures included testing that the assumptions related to various rates used within the actuarial calculations were reasonable. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|---|---|
| Significant Accounting Estimates – Employee Benefit Costs (continued) | <ul style="list-style-type: none"> There were various new union agreements that were ratified in 2005 and as a result the employee future benefit costs needed to be revisited to ensure there were no material changes. The City hired Mercer's to evaluate the impact of the new union agreements on the City's 2005 operating results. As a result of the review, there were no material adjustments required and as such, the City continued to use the previous projections for recording the changes to the 2005 consolidated financial statements. We understand that the City will be conducting an updated full valuation of the employee benefits in the upcoming year that will be used for the preparation of the 2006 consolidated financial statements. This new valuation will take into consideration all the current agreements with the City. | <ul style="list-style-type: none"> Our procedures included testing that the City was in full compliance with the appropriate accounting principles for the calculation, presentation and disclosure of these liabilities within the consolidated financial statements. We concur with the accruals made and the information presented within the consolidated financial statements. We encourage the City to ensure that the updated valuation for 2006 is done on a timely basis and that Mercer's is also aware that some of the entities within the City are reporting on a basis other than the public sector accounting rules, and as such, the accounting for the changes in the report may vary for this reason. The City should provide Mercer's with a list of the entities and what accounting rules are followed by each. |
| Significant Accounting Estimates – Environmental Liabilities | <ul style="list-style-type: none"> The provision for closure and post-closure costs for the City's landfill sites is one of the significant unfunded liabilities of the City. Currently, the City records environmental liabilities to the extent they relate to the closure and post-closure costs of their landfill sites. The accounting rules are very specific as to the recording, presentation and disclosure of these amounts within the consolidated financial statements. During the year, management identified an error in its calculation of these liabilities. As a result, the 2004 financial statements were restated and disclosed in Note 18 to the financial statements as follows: <ul style="list-style-type: none"> 2004 opening capital fund balance decreased by \$17,584,331 | <ul style="list-style-type: none"> Our audit procedures tested that the assumptions and rates used in the present value calculations were within our zone of reasonableness. We have tested current year transactions and found no exceptions. We have concluded the accruals are reasonable and the information presented within the consolidated financial statements is adequate. We have tested management's revised estimation calculations for 2004 and 2003 and concur with the restatement of prior years. Other environmental liabilities that may exist within the City are accrued to the extent that there is a legal obligation to remediate the properties to a certain level. Accruals beyond this point are not required under the current accounting standards. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|---|--|
| Significant Accounting Estimates – Environmental Liabilities (continued) | <ul style="list-style-type: none"> o 2004 environmental services expenses decreased \$1,226,368 o December 31, 2004 landfill closure and post-closure liabilities increased \$16,357,963 and December 31, 2004 amounts to be recovered increased \$16,357,963 | |
| Significant Accounting Estimates – Tax Provisions (not including Payments in Lieu of Taxes) | <ul style="list-style-type: none"> • Valuation of property taxes is a complex process within the City due to the number of rules and regulations. The appeal process alone creates many estimates and judgments around the valuation of tax receivables at the end of the year. As at December 31, 2005, the City has made a total provision against taxes in the amount of \$325,741,087 (2004 - \$287,253,448) of which \$272,965,449 (2004 - \$248,954,707) relates to assessments under appeal. The remainder of the provision is for other areas such as contaminated properties, vacancy rebates, charitable rebates and provision against interest charges. • We understand that, in 2004, management performed an analysis based on appeals from 1998-2002 and arrived at a rate of 6.49% as compared to the 7% suggested by MPAC to use in estimating an allowance against taxes for successful appeals. The City has kept the rate at 7% on the basis that most of the history related to residential properties and there was an expected increase in connection with the commercial property assessments that would increase the rate from 6.49% to closer to 7%. Therefore 7% was considered a reasonable basis for providing for an allowance against taxes. • For 2005, management continued to use 7% of the assessed value of the properties under appeal as a basis for the year end provision, however, MPAC has changed its approach to include both appeals and reconsiderations and considers a reasonable provision would not exceed 0.75% of the total assessment base of the City, not just amounts under appeal. | <ul style="list-style-type: none"> • Our audit procedures include a review of the City's process for estimating the impact of appeals on current receivables recorded by the City. In addition, we correspond directly with the Municipal Property Assessment Corporation (MPAC) on the rate of appeals heard and won to test the reasonableness of estimates made by City staff at year end. • Based on the new benchmarks provided by MPAC in evaluating the reasonableness of the provision made, the City has provided for an amount equal to approximately 0.10% of the total assessment base (or 7% of the assessed values of the properties under appeal), which is within the guidelines determined by MPAC. • We concur with the provisions made. • Based on our review of the assumptions used by management, historical experience with collection and subsequent receipts of receivables, we concur with the reasonableness of provisions for taxes receivable made by City staff. • We do encourage management to continue to monitor the history of the City's appeals in order to provide a stronger basis for the provisions made based on their own experience rather than that of MPAC. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|---|--|
| Significant Accounting Estimates – Tax Provisions (not including Payments in Lieu of Taxes) (continued) | <ul style="list-style-type: none"> Another significant accounting estimate in the taxation area is with respect to vacancy rebates. Application for vacancy rebates relating to 2005 were accepted until February 28, 2006. The City is currently processing 2004 vacancy rebates and will continue to process 2004 and 2005 rebates over the upcoming months. Since vacancy rebates are not processed on a timely basis, the City estimated the 2005 vacancy rebates based on the most recent completed year. As a result, the 2005 vacancy provision was based on processed 2003 applications. The increase in the total provision against taxes in the current year was the result of significant increases in the assessment values of properties under appeal and the addition of 2005 vacancy rebates in addition to adjustments related to unprocessed 2004 rebates. | |
| Significant Accounting Estimates – Payments in Lieu of Taxes | <ul style="list-style-type: none"> Payments in lieu of taxes are payments made to municipalities by entities that are part of the provincial or federal government for properties that are exempt from property taxation, which mainly consist of Crown properties. These entities can decide whether or not they will pay these amounts and how much they will pay. Collection history indicates that these entities will pay based on their own methods of calculating the levies, which may include the utilization of their own property assessment database, applying adjustments to the levy such as capping and clawback, and/or budgetary constraints. | <ul style="list-style-type: none"> Based on our review of the assumptions used by management, historical experience with collection and subsequent receipts of receivables, we believe some payments in lieu may be collectible and have been overprovided for. We have taken this overprovision to our summary of audit differences, as a judgmental difference. See "Summary of Audit Differences" section. |
| Significant Accounting Estimates – Water Receivable and Provision | <ul style="list-style-type: none"> The water accrual at December 31, 2005 captures revenue between the last billing dates to the year-end for each individual account and is based on consumption estimates produced by WMACS multiplied by a seasonal factor as determined by management. | <ul style="list-style-type: none"> Based on our review of the assumptions used by management and the subsequent billings for 2005 consumption, we concur with the reasonableness of accruals for water consumption made by City staff. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|--|---|
| Significant Accounting Estimates – Water Receivable and Provision (continued) | <ul style="list-style-type: none"> The provision for non-collectible water accounts has decreased from the prior year (\$11,400,000 versus \$11,700,000 in 2004). The provision mainly relates to old accounts prior to the new policy adopted in 2003 allowing uncollected charges to be added to the tax roll. In 2005, approximately \$13 million was transferred to the tax roll as compared to \$0.7million in 2004. In addition, the City's collection policy, which involves arrears notices, use of collections agencies and water shut-off, has reduced the need for a provision increase in the current year. Non-linked water accounts are accounts for tenants who live in multi-residential or condominium units, where the units are registered under the owner of the property. As a result, arrears for these accounts, which are the responsibility of the tenant, cannot be added to the owner's tax roll. The provision relating to these accounts is estimated by applying a percentage based on historical experience to accounts under investigation and applying a similar percentage to an estimate of the year-end water accrual that relates to non-linked accounts. | <ul style="list-style-type: none"> We reviewed the detailed outstanding receivables balances in light of the City's collection strategy. Based on our review of the assumptions used by management and historical experience with collection, we concur with the reasonableness of provisions for water receivables made by City staff. |
| Significant Accounting Estimates – Other Provisions | <ul style="list-style-type: none"> In addition to the significant provisions and estimates noted above, the City makes provisions against various other receivables outstanding at the end of the year. These receivables include amounts related to user charges, parking tags and various other miscellaneous receivables. | <ul style="list-style-type: none"> Through our audit procedures, we review the significant receivable balances that exist at year end and review the support and work done by staff in developing estimates of uncollectible amounts. Since provisions entail a significant amount of judgment, our audit procedures tested that the basis of the estimates used and the ultimate provisions made are reasonable within our professional judgment. We agree that the estimates of the provisions made against the significant balances as at December 31, 2005 are reasonable. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|--------------------------------------|---|--|
| Consolidation | <ul style="list-style-type: none"> The City's budget and the day-to-day accounting within SAP are prepared on the cash basis. At year end, a process is followed by Accounting Services to ensure that the final numbers for the City's consolidated financial statements are prepared on the accrual basis in accordance with the Public Sector Accounting Board standards, which is the basis of accounting to be followed under the Ontario Municipal Act. This process involves consideration of all appropriate information from the City's information system, other relevant support and information from various departments and the financial statements from each of the City's Agencies, Boards and Commissions (ABC's) that form a part of the consolidated entity. Each of the ABC's have stand alone accounting systems and report based on the generally accepted accounting principles applicable to their organization, which may not be the same as the principles applied by the City. As a result, consolidation is a complex and manual process. | <ul style="list-style-type: none"> Our audit procedures are designed to test that all entities are appropriately accounted for within the consolidated financial statements and that all required entries are made so that the City's financial information is consistent with generally accepted accounting standards applicable to the City. See the discussion below in "Elimination of Inter Entity Balances" for further details on the ABC eliminations. In addition, through the consolidation process, we do review the audit results of the consolidated entities to ensure we recognize any amounts not adjusted through their statements. One amount for TTC has been recorded on the "Summary of Audit Differences" for 2005. We have noted that the complexity of the current process increases the potential of errors, and as such, we have included a formal management letter point in 2005. Refer to the "Letter of Recommendations" section for further details. |
| Elimination of Inter Entity Balances | <ul style="list-style-type: none"> Part of the City's consolidation process is the elimination of inter entity balances based on the results of the various local agencies, boards and commissions. These eliminations are performed based on the amounts reported within the various agencies, boards and commissions and may not agree in their entirety with the amounts recorded within the City's accounts. As the City has continued to analyze its inter entity accounts, and through the course of our audit, errors have been identified, some as a direct result of the complex manual adjustments referred to in the consolidation comment above. | <ul style="list-style-type: none"> We audit the schedules and information provided to us by Accounting Services in detail and as a result have taken a few items to the "Summary of Audit Differences". Our review of the eliminations that should have occurred between the entities has shown that there is one known error (\$1.9M) and one judgemental error (\$2.4) for amounts that have not been eliminated on the consolidated statements. While we have satisfied ourselves that there are no material differences in the consolidated financial statements, we have recommended to management that the City continue its efforts in reconciling its inter entity balances on a regular basis, which will ensure account balances are eliminated entirely upon consolidation. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|--|---|
| Elimination of Inter Entity Balances (continued) | | <ul style="list-style-type: none"> We concur with restatement of prior years' amounts with respect to Toronto Community Housing Corporation, which is described in Note 18 to the financial statements. We concur with the eliminations made as at December 31, 2005. |
| Sale of Street Lights | <ul style="list-style-type: none"> On December 30, 2005, Toronto Hydro Street Lighting Inc. (THSLI) entered into an Asset Purchase Agreement with the City of Toronto. In accordance with the terms of this agreement, the City, which owns the street and expressway lighting system (SEL) in the City of Toronto, has agreed to sell to THSLI certain of those assets and other rights associated with the street and expressway lighting system for a cash consideration of \$60 million. The effective date of the transaction was December 31, 2005. The transaction was recorded as an increase in property, plant and equipment at the exchange amount of \$60 million in the books of Toronto Hydro and as a reduction in the City's share of net equity in Toronto Hydro (Investment in Government Business Enterprises) as at December 31, 2005. THSLI also entered into a Street and Expressway Lighting Service Agreement, with the City of Toronto. Under this agreement THSLI shall provide street and expressway lighting services to the City including the management and operation of the SEL System and the design, installation, maintenance and repair of the SEL System for an annual fee. | <ul style="list-style-type: none"> We have reviewed the Assets Purchase Agreement, the Street and Expressway Lighting Service Agreement and the valuation report issued by Deloitte and Touche as part of our audit procedures. We have also assessed the reasonableness of the valuation and assumption used by management in determining the fair value of the assets. Transactions of this nature between related parties would normally be recorded at the carrying value of the vendor. The acquisition of these assets was recorded at exchange amount in the accounts of THSLI since the carrying value of the assets is not recorded on the books and records of the City and the historical cost was not determinable. Toronto Hydro is a government business enterprise that is accounted for on a modified equity basis in the City's financial statements. The modified equity basis does not adjust the accounting of the entity to that of the City's nor are inter-organizational transactions and balances eliminated (such as streetlighting etc.). However, under Public Sector Accounting Rules, inter-organizational gains and losses are eliminated on assets remaining within the government reporting entity at the reporting date. Based on our procedures we concluded the accounting and disclosure for this transaction is appropriate. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---|---|---|
| Gas Tax | <ul style="list-style-type: none"> In October 2004, the Province introduced gas tax funding to municipalities for public transit and in June 2005, a joint announcement by the Federal, Provincial, and City of Toronto governments and the Association of Municipalities of Ontario was made in connection with the signing of two federal gas tax funding agreements. Revenues related to this new funding have been recognized by the City in the amount of \$236 million. | <ul style="list-style-type: none"> We have reviewed the agreements and tested that the gas tax funds were used for the purposes intended. The City has directed the use of these funds to transit and since the amounts were spent in the year, all revenues were recognized in the year. No balances remain within the City's obligatory reserve funds, which are shown as deferred revenue on the consolidated statement of financial position, as at December 31, 2005. Based on our procedures, we believe the accounting and disclosure relating to this funding is appropriate. Through our review of the agreements, we noted that the City is required to prepare an annual expenditure report relating to this funding which is to be audited by an external auditor. Management will need to ensure they comply with this part of the agreement. |
| Enwave (Share capital and Income Trust) | <ul style="list-style-type: none"> Subsequent to Enwave's October year end, the City agreed to a capital call notice dated Nov 2, 2005 from Enwave that requested the City to subscribe for additional shares in order to maintain a 43% ownership of Enwave. During 2005, Council approved a reorganization plan for Enwave Energy Corporation ("Enwave") as approved by the Enwave Board of Directors. | <ul style="list-style-type: none"> We agreed the capital call transaction to a City report for the authorization of the additional share purchase. As of the audit report date, there has been no reorganization and as such there is no subsequent event disclosure required in the financial statements. We concur with the accounting and reporting of the Enwave transactions in the 2005 consolidated financial statements. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---------------------------------|--|---|
| Note Receivable – Toronto Hydro | <ul style="list-style-type: none"> The City holds a note receivable from Toronto Hydro in the amount of \$980 million maturing May 7, 2008 and bears interest at a rate of 6.8% per annum. This note is accounted for as a financial asset in the consolidated statement of financial activities and is disclosed in note 4 to the consolidated statements. City Council, on February 6, 2006, exercised its option under the terms of the note to extend the maturity date from 2008 to May 6, 2013. An Ontario Energy Board ("OEB") directive subsequent to year end permits that Toronto Hydro can only recover 5% interest on debt in its rates charged to customers. Therefore, Toronto Hydro is seeking to revise the interest rate on their promissory note with the City. | <ul style="list-style-type: none"> We understand that there are ongoing discussions within the City on the resolution of this matter. We concur with the note disclosure in Note 4 to the consolidated financial statements. We agree that the resolution of the interest rate matter is a 2006 issue and is not significant enough to warrant disclosure within the City's 2005 consolidated financial statements as a subsequent event. Any potential rate changes will only apply to 2006 and future years. |
| Cash | <p>During the course of our audit, we noted various observations with respect to the accounting for and administration of the City's cash accounts:</p> <ul style="list-style-type: none"> Foreign cash transactions are automatically converted into Canadian dollars by SAP using pre-established foreign exchange rates. During our review of bank accounts, we noted that for one US-dollar account, the conversion rate was manually overridden in SAP, resulting in an incorrect foreign exchange used for the ending cash balance. | <ul style="list-style-type: none"> Although the foreign exchange error was immaterial, EY noted that the conversion rates embedded in SAP should not be manually overridden. The application of incorrect exchange rates to larger cash balances could result in a material foreign exchange error in the future. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|------------------|---|--|
| Cash (continued) | <ul style="list-style-type: none"> In the Parks, Forestry and Recreation Division, cash receipts are processed by the CLASS system in batches and then uploaded into SAP. During the review of the year-end bank reconciliation, we noted \$6.3M in deposits recorded in the general ledger that could not be traced to CLASS and \$6.4M in deposits recorded in CLASS that could not be traced to the general ledger. The differences are due to time lags in recording credits and refunds in SAP and as a result, CLASS does not reconcile to SAP. The City has several bank accounts that are treated as petty cash. For one of these accounts, we noted that the year-end balance in the general ledger of \$100,000 was significantly lower than the actual bank balance of \$3.9 million. This difference is due to payments in transit being booked into a general disbursements account rather than the specific general ledger account. | <ul style="list-style-type: none"> The net difference of \$0.1million is immaterial to the financial statements as a whole. However, the failure to reconcile cash deposits from CLASS to SAP could lead to errors that may go undetected, resulting in an incorrect cash balance. The failure to record transactions in the appropriate GL account results in the misstatement of individual cash balances. We recommend that management review the process by which cash transactions are recorded to ensure that GL balances reasonably reflect the bank balance at year-end. |
| Reserve Funds | <p>During the course of our audit, we noted various observations with respect to the accounting for and administration of the reserve funds:</p> <ul style="list-style-type: none"> Throughout the year, Council will approve the establishment of various new reserve funds through Council direction or by virtue of an obligatory reserve. In many instances, there are no financial transactions upon this approval - just the approval of the fund so there is a mechanism for tracking funds once they are received. For 2005, we noted six obligatory funds were approved by Council but had not been set up as at year end. There was no financial activity in any of these funds as at December 31, 2005. | <ul style="list-style-type: none"> Although there is no significant impact on the consolidated financial statements for 2005, we do recommend that management adopt a more proactive basis for setting up reserve accounts to ensure that Council direction is being adhered to on a timely basis. By not recording the funds appropriately as they are approved, there is a risk that a fund could be overlooked or transfers are not occurring in the appropriate period. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---------------------------|---|--|
| Reserve Funds (continued) | <ul style="list-style-type: none"> In addition, we noted the approved transfer of the CNEA Prize Fund to the Canadian National Exhibition Association Foundation at the October 2005 Council meeting. The physical transfer of the funds did not occur until after year end although approval was given before year-end. The balance of this fund is \$157,000 and not significant to the City's statements and therefore no adjustment was made at December 31, 2005. | |
| Reserves | <ul style="list-style-type: none"> In completing our audit procedures of the Reserve balances, we noted that the Water Stabilization Reserve continues to be in a negative position due to the large withdrawal from the account in 2004. This Stabilization Reserve for financial reporting is combined with the other Water and Wastewater reserves which cumulatively are in a positive position and are reported together in the consolidated financial statements. Since there are insufficient funds in this reserve to fund water and wastewater operations, funds were not transferred from this reserve in 2005. Per the 2005 preliminary reserves and reserve funds variance report, the City expects this deficit to be offset by contributions from water and wastewater operations in future years. The deficiency for 2005 for water operations of \$7,480,281 was to be funded from this reserve, however, instead of creating a larger deficiency in the balance the amount was funded from amounts that were budgeted to be transferred into the water capital reserve fund. | <ul style="list-style-type: none"> We noted that there was no Council approval for this reallocation of funds - the reallocation was agreed upon by Financial Reporting and Financial Planning management staff of the City. Since this change has no impact on the consolidated statement of financial activities and would at the most only represent a misclassification between the reserve and reserve fund balances as reported on schedule 3 of the consolidated financial statements, we have accepted the transfers as presented. |

Areas of Audit Emphasis and Items of Audit Significance Discussed with Management

| Item | Description | Audit Results and Comments |
|---------------------------------|---|---|
| Capital Asset Reporting | <ul style="list-style-type: none"> Included in our 2005 planning package and in previous year's reporting packages to you, we have informed you of upcoming changes to reporting developments that may have a significant impact on the City. Capital asset reporting is a significant upcoming change that will require a lot of time and resources for the City to implement. | <ul style="list-style-type: none"> We understand that the City has been proactive with regards to this new standard and is very involved in pilot projects currently underway related to the implementation of the new requirements. We strongly encourage management the City to continue actively addressing this change to ensure that the City is ready for the new reporting requirements. We also recommend that City staff consider the impact of this new standard on the Agencies, Boards and Commissions. As management addresses the required changes to implement this new standard, it is important that they maintain an adequate audit trail to permit us to verify the changes as part of our audit process. |
| Changes to Financial Statements | <p>The significant changes to the 2005 financial statements (as compared to the 2004 presentation) are as follows:</p> <ul style="list-style-type: none"> Significant accounting policies: <ul style="list-style-type: none"> Claim provisions Note 2: Change in Accounting Policy Note 14: Public Liability Insurance removed (see Note 2 and 16) Note 18: Comparative Consolidated Financial Statements | We concur with the changes made. |

Summary of Audit Differences

During the course of our audit, we accumulate differences between amounts recorded by management and amounts that we believe are required to be recorded under generally accepted accounting principles. Following is a summary of those differences:

| | Recording Differences Would Have Increased (Decreased) Municipal Position or Net Revenues | |
|--|--|-------------|
| | <u>2005</u> | <u>2004</u> |
| | \$ | (000's) \$ |
| Known Audit Differences: | | |
| Overaccrual of deferred revenues | 1,957 | 0 |
| Overaccrual of TTC expenses | 1,500 | 1,500 |
| Overaccrual of Toronto Hydro tax reserves | 0 | 1,720 |
| Underaccrual of provision for taxes | 0 | (768) |
| Likely Audit Differences: | | |
| Overaccrual of provision for payment in lieu of taxes | 2,571 | 0 |
| Overaccrual of deferred revenues | 915 | 1,108 |
| Overaccrual of accounts payable | 2,483 | 0 |
| Total Unadjusted Audit Differences Before Turnaround Effect of Prior Year Differences | 9,426 | 3,560 |
| Turnaround Effect of Prior Year Differences in Net Municipal Position | (3,560) | |
| Total Unadjusted Audit Differences in Income After Turnaround Effect of Prior Year Differences | 5,866 | |

- Management has concluded that these differences are not material, either individually or in the aggregate, to the financial statements taken as a whole.
- In evaluating these differences we considered both qualitative and quantitative factors. Materiality is a matter of professional judgment, but as a general rule is judged in relation to the reasonable prospect of an item's significance in the making of decisions by the readers of financial statements.
- We concur with management's conclusion that these differences are not material to the consolidated financial statements taken as a whole.

Independence Letter

May 30, 2006

Members of the Audit Committee
of the Council of the City of Toronto

Dear Members of the Audit Committee:

We have been engaged to audit the consolidated financial statements of the City of Toronto ("City") for the year ending December 31, 2005. Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the City and us that, in our professional judgment, may reasonably be thought to bear on our independence.

In determining which relationships to report, these standards require us to consider relevant rules and related interpretations prescribed by the appropriate provincial institute / ordre and applicable legislation, covering such matters as:

- (a) holding a financial interest, either directly or indirectly, in a client;
- (b) holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
- (c) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
- (d) economic dependence on a client; and
- (e) provision of services in addition to the audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters arising since the date of our last letter.

We are not aware of any relationships between the City and us that, in our professional judgment, may reasonably be thought to bear on our independence, that have occurred from April 29, 2005 (the date of our last letter) to May 5, 2006.

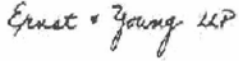
The total fees charged to the City during the period from January 1, 2005 to May 5, 2006 are set out in the Audit Results package.

Independence Letter

GAAS require that we confirm our independence to the audit committee, in the context of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario. Accordingly, we hereby confirm that we are independent with respect to City within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of May 5, 2006.

This report is intended solely for the use of the Audit Committee, Council, management, and others within the City and should not be used for any other purposes.

Yours truly,



Martha Tory/Diana Brouwer /Kathi Lavoie
416-943-3678/905-882-3037/905-882-3056

Letter of Recommendations

May 30, 2006

To the Audit Committee of the
of the Council of the City of Toronto

Dear Members of the Audit Committee:

Re: Recommendations to Management for the year ended December 31, 2005

In planning and performing our audit of the consolidated financial statements of the City of Toronto (the "City") for the year ended December 31, 2005, we considered the City's internal control structure to determine our auditing procedures for the purpose of expressing our opinion on the financial statements under Canadian generally accepted auditing standards and not to provide assurance on internal control. Our consideration of internal control for the limited purpose of determining the nature, timing, and extent of our auditing procedures to express an opinion on the City's December 31, 2005 financial statements would not necessarily disclose all deficiencies in internal control over financial reporting and therefore was not designed to determine whether the City's system of internal control is adequate for management's purposes.

Our review of the controls for 2005 did take into consideration various reports issued by the Auditor General in the current year and previous years and we have not repeated his observations and recommendations within this letter. We will continue to monitor observations made by the Auditor General for any impacts the recommendations may have on our planning of subsequent year's audits. We have reviewed the report submitted by management to the February 2006 Audit Committee – Workplan Update (update on issues raised in auditor management letters). We have not repeated the comments within this letter but wish to note that we have reviewed the points and comments made by management within that report. With the exception of two points noted below, we agree with those points considered closed, and we will monitor the remaining outstanding points during the course of future year's audits.

The following points management considered to be closed in their workplan update submitted to Audit Committee for the February 2006 meeting, but are considered to still be open by us:

- 2000 – Finance - Accounting for Contributions for ABC's to the City's Employee Benefit Reserve Funds
- 2003 – Information Technology – SAP Security

The above noted points have been included in this letter and updated for any current information.

The prior year points remaining open and monitored by Finance for future workplan updates are summarized as follows:

- 2000 – Finance - Environmental Liabilities
- 2001 – Information Technology - Disaster Recovery Planning
- 2001 – TPS - Information Technology – Disaster Recovery Planning
- 2001 – TPS - Information Technology – Information Security

Letter of Recommendations

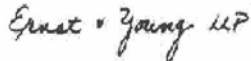
- ✎ 2003 – Finance/WES – Deposits
- ✎ 2004 – Former North York Fence Deposits
- ✎ 2004 – Vacation Accrual Days Not Recorded in SAP

While our purpose was not to provide assurances on the internal control structure, certain matters beyond those referred to above, came to our attention where we feel management can either strengthen controls or improve efficiencies within its current processes. Our study and evaluation disclosed no condition that we believed to be a material weakness but did disclose certain areas for which we believe further review by management is warranted.

All suggestions and comments outlined in the attached memorandum concern systems, accounting or business matters and are not intended to reflect in any way upon your personnel. Recommendations to management for the individual Agencies, Boards and Commissions have been presented to their respective Audit Committees or Boards of Directors and are included within each of their respective "2005 Audit Results Packages" which are forwarded to the City of Toronto Audit Committee at the same time as their respective audited financial statements are forwarded. Other comments observed by us and should be considered by management, are reflected within our discussion in this results package under "Areas of Emphasis and Significant Items Discussed with Management".

We wish to acknowledge the co-operation and courtesy extended to us by your personnel and wish to thank them for their assistance during our audit. If there are any matters included in the memorandum that you would like to pursue at greater length, we would be pleased to discuss them with you.

Very truly yours,



Martha Tory/Diana Brouwer /Kathi Lavoie
416-943-3678/905-882-3037/905-882-3056

2005 – Consolidation Process

Observation

The City's process for consolidating all of its agencies, boards and commissions ["ABC's"] within the City's financial statements is a very complex and manual process. The complexity is created by the nature and volume of these adjustments significantly increases the risk of error.

As part of this process, the City consolidates and eliminates accounts with its ABC's based on the audited financial statements of each of these entities. As the City has continued to analyze its intercompany accounts, errors have been identified, some as a direct result of the complex manual adjustments referred to above.

Recommendation

We recommend that management revisit the consolidation process to find ways to increase the efficiency of this process and, where possible, remove recurring manual entries that could be recorded directly in SAP.

Management Response

The consolidation process will be reviewed during 2006 and improvements will be implemented, where possible, to increase the efficiency of this process.

2005 - Contingent Liability Estimation

Observations and Recommendations

Reconciliation of Data

The City's insurance agents manage the majority of the City's claims and track the progress of these claims in their own databases. These databases are regularly uploaded to the City's STARS database; however, this is occurring less frequently as the City is currently making changes to its system. The last update to the system was on January 25, 2006 for information up to December 31, 2005.

There are inconsistencies that currently exist between information in the City's database and these 3rd parties. These inconsistencies occur as some of the City's claims are managed internally and any updates made by the City are not reflected in the agents' databases. As a result, upon uploading changes from the agents, updated claims information in the system may revert back to the data which exists in the agents' databases. These inconsistencies are identified by the City upon review of the status of the internally managed claims.

As recent changes to the public sector accounting rules require recording of the City's contingent liabilities, it becomes more critical that the City's claims database remains current and reconciled with its agents as these amounts form the basis of a significant accounting estimate that is now recorded in the City's financial statements.

Completeness of Accrual

The City engaged Mercer Oliver Wyman to estimate its contingent liability reserve based on its most significant areas of claims (general liability and automobile liability) and examined the activity of these claims filed on or after January 1, 1998 to December 31, 2005. While this estimation captures the most significant areas, it ignores pre-1997 claims and all property and non-insurance related claims. The contingent liability with respect to these claims was determined through individual claims review and assessment of the likelihood of loss and an estimation of the amount of loss. While the outcome of these claims is more readily estimable and may not require complex estimation valuations, in general, the City should apply the same rigor to all claims in estimating the likelihood of their eventual settlement as these liabilities are now recorded in the City's financial statements.

Management Comments

The conversion of claim records to a web-based system will enable both City staff and the insurance adjuster to access and update claims records. This process, commenced earlier this year, will eliminate the need to reconcile data in two separate systems and is expected to be operational by July 2006.

Claims data was provided to the actuary for the purpose of estimating loss reserves and did not include all outstanding claims due to the loss of some data during the conversion of records to the new web-based system. This situation is not expected to occur in future years.

2005 - Contract Management*Observation*

During our testing of controls on purchases, we identified one purchase for which two contracts were created within SAP. Each of these contracts was assigned a unique contract number. When this contract error was identified it was not cancelled and divisions were able to draw on this contract through contract release orders or invoices. When combined, draw downs on the two contracts did not exceed the approved amount of the initial contract, however, the creation of duplicate contracts in error could result in spending in excess of authorized amounts.

Recommendation

The contract number or purchase order should be indicated on the purchase requisition as evidence that a contract or purchase order has been created. There should be a process to follow up and cancel any contracts or purchase orders identified by SAP as created in error so that they are cancelled immediately.

Management Comments

This error occurred when established procedures in the processing of a contract in SAP were not followed. Staff have since been reminded of the correct procedures to be followed in order to help avoid similar problems in the future.

2005 – Document Management System***Observation***

We understand that City Council, at its meeting of January 31, 2006, has adopted a clause in the Administration Committee Report 1 with respect to the request for proposal for Document Management System Initial Implementation Solutions. From our understanding of this approved clause and from discussions with management, we understand that the City is looking to implement an electronic records management component to this system whereby, documents are scanned and converted into electronic images to facilitate storage and reference, and the source documents may not be retained after conversion.

Recommendation

We recommend that management ensure there is involvement of the external auditor in the implementation of this new system to the extent that the auditors will need to place reliance on the scanned documents.

The use of electronic evidence in the form of electronic copies of documents creates the need for us to identify, document and evaluate the controls over the creation of such electronic evidence. If our client uses a scanning/imaging system to process source documents, we can print a document or screen capture from this system in lieu of the original document only if we document and test controls over the scanning/imaging of documents that ensure the accuracy and completeness of scanned items.

Management Response

We agree and will involve a number of interested parties, including internal audit, divisional representatives and our external auditors in this process. The requirements of these groups and those of the Canada Revenue Agency will be incorporated in the procedures developed on the use of a document management system.

2005 – Information Technology – SAP User Termination Process***Observation***

Notifications to remove terminated employees from SAP are not consistently communicated from the departments of the terminated user to the relevant SAP administrators on a timely basis. In order to compensate for this, a review of the bi-weekly HR termination report and the monthly inactive user report in SAP is carried out by the SAP user administration group. However, this review was not performed consistently throughout the year.

As a result of these two issues, we noted thirty-one cases in which a user account in SAP was not removed within thirty days of the employee's termination date. These cases include high risk terminations such as layoffs and dismissals, and included one user who was not removed until over six months after departure.

Untimely removal of user access increases the risk of inappropriate access to financial transactions and data.

Recommendation

We recommend that the City formalize the termination notification process by making it a requirement within the termination process that the IT department is notified for all employee terminations.

In addition, the requirement for the bi-weekly and monthly reviews for terminated users should be documented to ensure that the review process does occur on a regular basis.

Management Response

We agree with the recommendation. The SAP Competency Centre will work with Accounting Services, Human Resources, and Payroll, Pensions and Benefits to develop and implement formal processes for termination notification, regular reviews, and inactive/terminated user account removal by end of August 2006.

2005 – Information Technology – SAP Configuration – Logging of Changes

Observation

Through our review of SAP configuration settings, we noted that SAP logging is currently not enabled. Failure to log and monitor changes to sensitive configuration information increases the risk that unauthorized or inappropriate activity will not be detected or followed up.

Recommendation

Management should review the feasibility of logging changes to specific sensitive SAP configuration information. Logging provides evidence of changes that can be periodically reviewed for appropriateness.

Management Response

We agree with the recommendation for sensitive configuration tables. Enabling full table logging would significantly affect system performance in the production system given the large number of tables, including many transactional tables, in the SAP system. The SAP Competency Centre, in consultation with the business stakeholders, will identify sensitive configuration tables and enable logging of these tables for monitoring by the third-quarter of 2006.

2005 – Information Technology – TMACS/WMACS Password Settings

Observation

We reviewed the password configuration settings for the TMACS and WMACS applications and identified the following weaknesses:

- The minimum password length for a TMACS or WMACS user account is four characters and does not enforce use of characters other than letters (i.e. numbers or capitals)
- Accounts are not disabled or locked after a user attempts to log-on with an incorrect password
- Users are not prevented from re-using previous passwords when changing their user account passwords.

These issues contribute to an increased risk of unauthorized or inappropriate access to the TMACS / WMACS applications.

Recommendation

We recommend that consideration be given to improving information security by improving password security at the TMACS and WMACS application level. This would involve:

- Enforcing a minimum password length of at least 6 characters;
- Enforcing an account lockout policy to disable or lock user accounts after repeated invalid access attempts; and,
- Enforcing a password history to prevent the re-use of the previous few (i.e. five) passwords.

Management Response

We agree with the recommendation. Enhanced password configuration settings will be implemented for TMACS and WMACS in the third-quarter of 2006.

2005 – Information Technology – Operating System and Data Security

Observation

During the review of the operating system and database configuration used to host the SAP application, we noted a number of configuration settings that could be improved to reduce the risk of unauthorized or inappropriate access to the system and to decrease the likelihood of unauthorized access going undetected.

Details have been provided to management for their follow up.

Recommendation

We recommend that the City review and assess the identified items and consider the feasibility of implementing the recommended improvements.

Management Response

We will review the operating system and database configuration settings identified in the areas of password policy, session timeout, audit logging, and parameter setting and make appropriate improvements.

2005 – TPS – Information Technology – TRMS/Peoplesoft User Administration

Observation

We noted that a central log of authorised user access requests for Peoplesoft and TRMS is not maintained by the user administrators (the ERMS team). The lack of a central log of requests increases the risk that the approvals for access to the applications are not retained.

Recommendation

We recommend that a central log of application access requests be maintained to ensure that all requests to add, change, and remove user access to the TRMS and Peoplesoft applications are retained for audit evidence.

Management Response

The current process for the actioning of user access requests for TRMS and HRMS is for members of the ERMS unit to action access requests from Information Security and assign the correct level of access. This information is currently tracked by maintaining all email requests from Information Security.

Effective, immediately, in addition to maintaining actioned email user access requests, the ERMS unit administrator will maintain a log of these requests.

In addition, the log will include a hard copy of the emailed request.

Update to February 8, 2006 Staff Report to Audit Committee on Update of Issues Raised in Auditor Management Letters

2000 – FINANCE – Accounting for contributions for ABC's to the City's employee benefit reserve funds – updated for current status

This point has been changed to reflect the current status of the observation and recommendation as of our audit report date for 2005. With the exception of the Toronto Community Housing Corporation ["TCHC"] portion as noted below, we agree that the point has been addressed.

Observation

In 2000, with a change in accounting rules for the recognition of employee future benefit costs, we commented on ABC's who had made deposits into the City's employee benefit reserve fund for funding of these costs as they became due. With the change in rules, these entities set up a receivable from the City equal to the amount of the liability recognized. With the exception of TCHC, the City is funding costs related to the ABC's on a cash flow basis. In addition, a report was tabled with Council in May 2005 on the degree of underfunding for these liabilities for the ABC's and a funding strategy to be considered in the 2006 budget process.

TCHC is a consolidated entity within the City with its own shareholder direction. Currently, we understand that there is no resolution on the funding status of the amounts booked as a receivable in TCHC and a payable in the City.

Recommendation

We recommend that the City work with TCHC on resolving this matter in 2006.

Management Comments

Discussions with TCHC staff will be arranged in an effort to resolve this matter in 2006.

2003 – INFORMATION TECHNOLOGY – SAP Information Security– updated for current status

Our 2003 point has been updated to reflect those areas we still consider to be open. The point related to the logging, has been reissued as a separate point in 2005.

Observation

We reviewed the security within the SAP application and noted that a number of individuals outside of the SAP Competency Centre are able to modify either the SAP system or the access privileges of users within SAP. Although these users may require certain high level access, not all of them require this level of access.

As a general principle, there should be a clear separation of duties between the Information & Technology division and the Finance function. Specifically, IT users should not be granted access to application functionality and business users should not be granted access to IT functions.

As a result of these issues, there is an increased risk of security violations within the SAP system and the potential for unauthorized changes and those changes not being detected.

Recommendation

We acknowledge that there are ongoing changes being made to the IT organization as the SAP Competency Centre continues to formalize processes and take on additional responsibilities in support of the SAP environment. We recommend the security settings in SAP be reviewed and revised as appropriate for these ongoing changes and to enforce a separation of duties between the Information & Technology division and business users. In addition, the access for high level users (those that are not in the SAP Competency Centre) should be reviewed in consultation with the process owners so that users have access only to those functions required to perform their job.

Management Comments

High level access is needed to manage / resolve issues arising from daily operational support. A formalized process has been in place for high level access transactions since Q3 of 2005. All high level access transactions identified in previous audits have been removed from all standard production system security profiles. When a high level access function is required to manage a production issue, an emergency profile with the high-level access is provided on a temporary basis by the business process owner to an individual user. The activity performed by the user using this emergency profile is logged and reviewed. The emergency profile is removed once the production issue is resolved.

Letter of Recommendations

2003 – INFORMATION TECHNOLOGY – SAP Information Security– updated for current status

Management Comments (continued)

An "Information Technology Governance and Organizational Design Review" is underway in 2006. This exercise will include a review of the account roles and responsibilities for the SAP Competency Centre and the key business stakeholders and process owners in the operation and support of installation. Recommendations will be made and an implementation plan will be developed by the fourth-quarter of 2006 that will address the separation of duties between the business users and the technical staff in the Information & Technology Division.



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Audit Results – City of Toronto