

City of Toronto

Audit Results – December 31, 2006

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

 **ERNST & YOUNG**

Quality In Everything We Do



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June 1, 2007

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 financial statements of the City of Toronto (the “City” or the “organization”).

This report to the Audit Committee summarizes 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, 2006 consolidated financial statements of the City. In planning the audit, we held discussions with management, considered current and emerging business risks, performed an assessment of risks that could materially affect the financial statements, and aligned our audit procedures accordingly. We received the full support and assistance of the organization’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, 2006 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 Committee in fulfilling its responsibilities.

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

Very truly yours,

Chartered Accountants
Licensed Public Accountants

Diana Brouwer /Kathi Lavoie
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Required Communications

Generally accepted auditing standards in Canada require the auditor to communicate certain matters to the Audit Committee that may assist them in overseeing management’s financial reporting and disclosure process. Below we summarize these required communications as they apply to your organization.

Area	Comments
<p>Auditors’ Responsibilities Under Generally Accepted Auditing Standards (GAAS)</p> <p>As set out in the planning document presented to the Audit Committee, we designed our audit to express an opinion on the City’s financial statements.</p> <p>The financial statements are the responsibility of management. Our audit was designed in accordance with GAAS to obtain 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 structure to plan our audit and to determine the nature, timing and extent of testing performed.</p>	<p>We anticipate issuing an unqualified audit opinion dated May 2, 2007 [except as to Note 8 which is as of May 7, 2007] upon approval of the financial statements by City of Toronto Council plus confirmation from the Audit Committee that there are no areas of concern that have not been addressed in this document and the letter of representation.</p>
<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 2006 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 acceptability of the policies or methods ultimately selected by management.</p>	<p>The City implemented a formal process with respect to the administration, management and disposition of taxpayer credit balances included in the City’s tax repayment account. We discuss this further within the “Areas of Audit Emphasis and Items of Audit Significance Discussed with Management”.</p>

Required Communications (continued)

Area	Comments
<p>Sensitive Accounting Estimates and Disclosures</p> <p>The preparation of financial statements requires the use of accounting estimates. Certain estimates and disclosures 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 the 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 the 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 Unrecorded Audit Differences Considered by Management to be Immaterial</p> <p>We provide the 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 the Audit Committee about unrecorded audit differences accumulated by us (i.e. adjustments either identified by us or brought to our attention by management) 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 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>
<p>Disagreements with Management</p>	<p>None.</p>
<p>Serious Difficulties Encountered in Dealing with Management when Performing the Audit</p>	<p>None.</p>

Required Communications (continued)

Area	Comments
Significant Weaknesses in Internal Controls	
We communicate all significant weaknesses in internal control over financial reporting that may have been identified during the course of our audit.	No significant weaknesses in internal control were identified.
Fraud and Illegal Acts	
We report to the 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.
We are also required to make inquiries of the Audit Committee related to fraud, including both (1) their views about the risks of fraud, and (2) their knowledge of any actual or suspected fraud.	We would request that the Committee members raise with us any areas of risk not addressed in our communications and that they inform us of their knowledge of any actual or suspected fraud.
Consultation with Other Accountants	
	None of which we are aware.
Other Information in Documents Containing Audited Financial Statements	
Our financial statement audit opinion relates only to the financial statements and accompanying notes. However, we also review other information in the Annual Report, such as Management’s Discussion and Analysis, for consistency with the 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.
Major Issues Discussed with Management in Connection with Initial or Recurring Retention	
	None.

Required Communications (continued)

Area	Comments
Matters Relating to Component Entities of the Organization	
<p>When the financial statements of an organization (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 the 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).</p>	<p>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 using 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).</p> <p>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).</p> <p>We are not aware of any matters relating to those entities that could have a significant impact on the City’s consolidated financial statements.</p>
Auditors’ Independence	
<p>Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between your organization and Ernst & Young that, in our professional judgment, may reasonably be thought to bear on our independence.</p>	<p>Refer to “Independence Letter” section.</p>
Other Audit and Non-Audit Services Provided to Your Organization	
	<p>Audit services provided to the City are in accordance with the request for proposal.</p> <p>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.</p>

Required Communications (continued)

Fees

Audit (City-only)

\$319,000

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 \$757,000 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 \$7,500 per report. We have also been the winning proponents of other RFP's for services with respect to Commodity Tax Audit and Recovery Services (fees of approximately \$150,000 based on savings realized by the City) and for the provision of professional services on the proposed project for Lamport Stadium (approximately \$20,000).

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
Tax Repayment Account	<ul style="list-style-type: none"> • The City implemented a formal process with respect to the administration, management and disposition of taxpayer credit balances included in the City's tax repayment account. • This process allows the transfer of credit balances to general revenues once the origin of the overpayment has been verified as a tax overpayment, sufficient due diligence has been performed to notify taxpayers of these credit balances, the amounts have remained in the tax repayment account for over three years, and there have been no subsequent repayments of balances after the three years. • As a result of this formal process, approximately \$49 million was recorded in revenue in 2006. This policy has been adopted prospectively and no prior periods have been restated. 	<ul style="list-style-type: none"> • Our audit procedures tested that only amounts that satisfied the criteria of this process were transferred to revenue during the year. • As a result of our audit procedures, we identified instances where documentation supporting sufficient due diligence of pre-amalgamation balances was not available, however, given the age of these balances, we considered the transfer appropriate. • The entry has been properly recorded in the City's consolidated financial statements.
Landfill Liabilities	<ul style="list-style-type: none"> • The City finalized an agreement to purchase the Green Lane Landfill in April 2007. • The purchase and the related closure and post-closure landfill liabilities have not been recorded in the accounts of the City in 2006 as title and possession did not transfer until 2007. • The City has disclosed the subsequent event in Note 6 of the consolidated financial statements. • Prior to December 31, 2006, the City made a \$10 million deposit to secure the purchase of the landfill that is recorded as a non-financial asset on the consolidated statement of financial position. 	<ul style="list-style-type: none"> • We have reviewed the purchase agreement and we concur with the accounting and disclosure presented in Note 6 of the consolidated financial statements.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
Significant Accounting Estimates – Employee Benefit Costs	<ul style="list-style-type: none"> • Future employee benefit costs represent a significant unfunded liability within the City. • Actuarial valuations for the other retirement and post-employment benefits are conducted on a periodic basis. The last actuarial review was completed by Mercer Human Resource Consulting in 2003 using the results as of December 31, 2002 that was projected forward for December 31, 2003 through to 2005. • The City was due to have an updated valuation performed in the current year but with delays in the proposal process, a full updated valuation will be performed as at December 31, 2006 for the 2007 year. • Mercer’s was contracted to update the previous valuation to December 31, 2006 for accounting purposes. The City has used these projected results provided by Mercer as at December 31, 2006 in recording the future employee benefit liability. There were no plan changes in 2006 that impacted the liability. • Mercer’s updated report did result in an actuarial gain of \$34.7 million that will be amortized beginning in 2007 over a 10-13 year period. 	<ul style="list-style-type: none"> • Our audit procedures included testing that there were no new agreements that would impact the projected results as at December 31, 2006. • Our procedures included testing that the assumptions related to various rates used within the actuarial calculations were reasonable. • 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 2007 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. • The accounting rules are very specific as to the recording, presentation and disclosure of these amounts within the consolidated financial statements. • 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. 	<ul style="list-style-type: none"> • Our audit procedures tested that the assumptions and rates used in the present value calculations were within a 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.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
<p>Significant Accounting Estimates – Tax Provisions (not including Payments in Lieu of Taxes)</p>	<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, 2006, the City has made a total provision against taxes in the amount of \$365,546,304 (2005 - \$325,741,087) of which \$311,549,566 (2005 - \$272,965,449) 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. • In 2006, management analyzed its at-risk rate on appeals based on appeals from 1998-2005 and determined that a rate of 7% (2005 – 7%) for amounts under appeal remained appropriate for Commercial and Industrial properties. Management’s analysis of the at-risk rate on appeals over the same period for the remaining property classes, namely Residential, indicated that a rate of 6% (2005 – 7%) was an appropriate rate for providing for amounts under appeal. • In prior years, the Municipal Property Assessment Corporation (“MPAC”) had suggested that a rate of 7% would be an appropriate rate for providing for amounts under appeal, however, in 2005 MPAC 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. Using this basis, the City’s provision for amounts under appeal was approximately 0.10% of its total assessment base. • Another significant accounting estimate in the taxation area is with respect to vacancy rebates. Application for vacancy rebates relating to 2006 were accepted until February 28, 2007. The City is currently processing rebates related to 2004, 2005 and 2006. Since vacancy rebates are not processed on a timely basis, the City estimated the 2006 vacancy rebates based on the most recent completed year. As a result, the 2006 vacancy provision was based on processed 2003 applications. 	<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 reasonability of estimates made by City staff at year end. • Based on the benchmarks provided by MPAC in evaluating the reasonableness of the provision made, the City has provided for an amount equal to approximately 0.1% of the total assessment base (or 6% or 7% of the assessed values of the properties under appeal), which is within the guidelines determined by MPAC. • 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.

Items of Audit Significance Discussed with Management (continued)

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"> 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 2006 vacancy rebates in addition to adjustments related to unprocessed 2004 and 2005 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 concur with the reasonableness of the provision for payments in lieu of taxes made by City staff.
Significant Accounting Estimates – Water Receivable and Provision	<ul style="list-style-type: none"> The water accrual at December 31, 2006 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. The provision for non-collectible water accounts has remained consistent with 2005 at \$11.2 million. 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 2006, approximately \$13 million was transferred to the tax roll as compared to \$19 million in 2005. In addition, the City's collection policy, which involves arrears notices, use of collection agencies and water shut-off, has reduced the need for any additional increase in the provision for the current year. 	<ul style="list-style-type: none"> Based on our review of the assumptions used by management and the subsequent billings for 2006, we concur with the reasonableness of accruals for water consumption made by City staff. Based on our review of the assumptions used by management, the City's collection strategy and historical experience with collection, we concur with the reasonableness of provisions for water receivables made by City staff.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
Significant Accounting Estimates – Water Receivable and Provision (continued)	<ul style="list-style-type: none"> 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. 	
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 concur that the estimates of the provisions made against the significant balances as at December 31, 2006 are reasonable.
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 and is required to recognize contingent liabilities (except for loan guarantees) when an event is likely to occur and is reasonably estimable. Management has assessed the likelihood of its contingent liabilities occurring, and in those instances where a liability is likely to occur, management has 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 reasonableness of the accrual and the information presented within the consolidated financial statements, including the disclosures in Note 15 of the consolidated financial statements.

Items of Audit Significance Discussed with Management (continued)

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. On February 6, 2006, City Council exercised its option under the terms of the note to extend the maturity date from 2008 to May 6, 2013. • On September 5, 2006, the note was amended to fix the interest rate at 6.11% per annum, effective May 1, 2006 and establish an agreed upon repayment schedule. • This note is accounted for as a financial asset in the consolidated statement of financial activities and is disclosed in Note 3 in the consolidated financial statements. 	<ul style="list-style-type: none"> • We concur with the disclosure in Note 3 to the consolidated financial statements.
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 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 on the “Summary of Audit Differences” in this results package. • We have noted that the complexity of the current process increases the potential of errors and, as such, we had included a formal management letter point in 2005. Refer to the “Letter of Recommendations” section for further details and updates in the current year.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
Reconciliation and 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 a difference has been taken to the “Summary of Audit Differences”. Our review of the eliminations that should have occurred between the entities has shown that there are judgmental differences (\$0.588 million) 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 facilitate the elimination of account balances upon consolidation. Refer to the “Letter of Recommendations” section for further details and updates in the current year.
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 funding have been recognized by the City in the amount of \$179.2 million (2005 - \$139.9 million). 	<ul style="list-style-type: none"> • 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, 2006. • Based on our procedures, we believe the accounting and disclosure relating to this funding are appropriate.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
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"> • The City has three bank accounts that have remained inactive for the past two years. • 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 \$6.3 million in deposits recorded in the general ledger that could not be traced to CLASS and \$6.4 million 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. 	<ul style="list-style-type: none"> • Keeping inactive bank accounts increases the City's risk of misappropriation of funds. We recommend these inactive accounts be closed. • The net difference of \$0.1 million 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. Differences should be followed up by management on a timely basis.
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 2006, 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, 2006. 	<ul style="list-style-type: none"> • Although there is no significant impact on the consolidated financial statements for 2006, 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.

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
Capital Asset Reporting	<ul style="list-style-type: none"> • Included in our 2006 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 City management 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.
Financial Instruments	<ul style="list-style-type: none"> • As noted under "New Developments in Accounting or Auditing Standards" in our planning document to the various ABC's, there are changes in the accounting for and disclosures related to financial instruments. • The new rules are effective for the City's ABC's fiscal 2007 year and although early adoption is permitted, we understand that they will be implemented in 2007. • The new rules will require consideration of such things as the categorization of investments – categorized as held for trading, available for sale etc. and additional disclosures required by the new standards. • Management will need to ensure they understand the new rules and the impacts on the 2007 financial statements of the ABC's and on the City's consolidated financial statements. 	<ul style="list-style-type: none"> • Management needs to ensure that they are identifying where all instruments impacted by these rules exist (e.g. hydro contracts, debt/financing arrangements, etc.) and the impact of these on their 2007 reporting. In addition, management needs to ensure the appropriate approvals by the Board have been made for their investment classifications in their 2007 financial statements. • Given the complexities of the new standard, we recommend that City finance staff evaluate the contracts that are shared with the ABC's (e.g. Hydro) and provide the appropriate accounting and disclosures to the ABC's

Items of Audit Significance Discussed with Management (continued)

Item	Description	Audit Results and Comments
New City of Toronto Act	<ul style="list-style-type: none"> • Bill 53 enacts revisions to the City of Toronto Act, 1997 (Nos. 1 and 2) and amends certain public Acts in relation to municipal powers and repeals certain private Acts relating to the City of Toronto. The bill received first reading on Dec 14, 2005, a second reading was debated on February 13, 2006 and the bill was passed on June 12, 2006. The new Act is effective as of January 1, 2007. • Some highlights of the revisions include the following: <ul style="list-style-type: none"> ○ the Act provides for a review after two years and then every five years thereafter. ○ Part II of the Act governs the City's general powers (currently this is under the Municipal Act). ○ provisions are made in certain sections that powers be interpreted broadly and specifically authorizes the City to provide any service that it considers necessary or desirable for the public. 	<ul style="list-style-type: none"> • There was no new significant accounting processes implemented in the current year as a result of the new City of Toronto Act. As a result, no change in our audit strategy was required. • We will monitor this for the 2007 audit as the City considers exercising some of its new powers.

Summary of Audit Differences

During the course of our audit, we accumulate differences between amounts recorded by your organization and amounts that we believe are required to be recorded under generally accepted accounting principles. Following is a summary of those differences we have identified through the date of this report:

	Recording/Differences Would Have (Increased)/Decreased Net Expenditures	
	2006 \$	2005 \$
Known Audit Differences – City:		
Overaccrual of deferred revenues	—	1,957
Overstatement of revenue for change in reserve fund from obligatory to discretionary	—	(2,100)
Understatement of liability for employee future benefits	—	(1,824)
Known Audit Differences – TTC (as reported on to the TTC Board):		
Overaccrual of TTC expenses re: contingent liability	1,500	1,500
Overaccrual of TTC losses on old tokens	(700)	—
Understatement of TTC deferred revenue related to new tokens	1,000	—
Understatement of TTC revenue re: tickets	—	2,140
Likely Audit Differences - City:		
Overaccrual of accounts payable – elimination of intercompany amounts with the ABC's	588	2,483
Overaccrual of deferred revenues re: fence deposits	912	915
Overaccrual of provision for payment in lieu of taxes	—	2,571
Total Unadjusted Audit Differences in Net Expenditures Before Turnaround Effect of Prior Year Differences	3,300	7,642
Turnaround Effect of Prior Year Differences in Net Expenditures	<u>(7,642)</u>	
Total Unadjusted Audit Differences in Net Expenditures	<u>(4,342)</u>	

Independence Letter

May 2, 2007

To 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 (the “City”) for the year ending December 31, 2006.

Pursuant to Canadian generally accepted auditing standards, we communicate at least annually with you regarding all relationships between Ernst & Young and its related entities and the Corporation and its related entities that, in our professional judgment, may reasonably be thought to bear on our independence.

We have prepared the following comments to facilitate our discussion with you regarding independence matters arising since April 28, 2006, the date of our last communication.

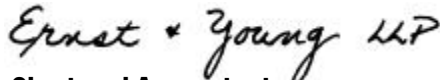
We are not aware of any relationships between Ernst & Young and the City that, in our professional judgment, may reasonably be thought to bear on our independence since April 28, 2006, the date of our last communication.

Canadian generally accepted auditing standards 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 the Corporation within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of May 2, 2007.

The total fees charged to the organization are set out in “Other Required Communications” in the Audit Results package.

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,



Chartered Accountants
Licensed Public Accountants

Diana Brouwer /Kathi Lavoie
416-943-7177/905-882-3056

Letter of Recommendations

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, 2006

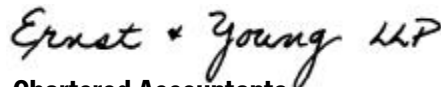
In planning and performing our audit of the consolidated financial statements of the City of Toronto (the "City") for the year ended December 31, 2006, we considered the City's internal control structure to determine our auditing procedures for the purpose of expressing our opinion on the financial statements 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, 2006 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.

While our purpose was not to provide assurances on the internal control structure, certain matters 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 "2006 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 that 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,



Chartered Accountants
Licensed Public Accountants

Diana Brouwer /Kathi Lavoie
416-943-7177/905-882-3056

Audit Results – City of Toronto

Letter of Recommendations (continued)

2006 – Finance - Reconciliations between the City and its Agencies, Boards and Commissions

Observation

In the City's business activities with its ABC's, we have identified instances where the accounting treatment for various transactions is not consistent between both parties and has resulted in differences in how the transactions are recorded.

Recommendation

We recommend that the appropriate accounting treatment for various transactions between the ABC's and the City be agreed upon at the time new agreements are entered into. A process that the City could look at to ensure any inconsistencies in accounting treatment are being identified in a timely manner would be the quarterly reconciliation of inter fund accounts.

Management Comments

We agree with this recommendation. Accounting Services will work with the Deputy City Manager and Chief Financial Officer to develop a process in 2007 whereby the Treasurer and Accounting Services are informed of all of these agreements on timely basis. Accounting Services will work with the ABC's to bring in consistent accounting treatment for new agreements and will evaluate the timing for the reconciliation of the inter fund accounts.

Letter of Recommendations (continued)

2006 – Finance - Preparation of Bank Reconciliations

Observation

During our audit, we observed that one bank account did not have bank reconciliations performed. Performance of reconciliations on a timely basis is a key control to ensure that any possible errors are detected and corrected.

Recommendation

We recommend bank reconciliations be prepared for every bank account.

Management Comments

We agree with this recommendation. Accounting Services has issued directives to all staff with bank reconciliation responsibilities to ensure that each account is reconciled on a monthly basis. The division currently receives the reconciliations for the City accounts on a monthly basis and follows up with each division when a statement is not received. This account was in the Social Development, Finance & Administration (SDF&A) Division.

Due to two staff vacancies there was a temporary delay in completing the bank reconciliations. The hiring process for both positions is underway and the expectation is that the backlog will be completed and future reconciliations will be performed on a timely basis. Reconciliations for 2006 are now complete.

Letter of Recommendations (continued)

2006 – Finance - General Ledger Accounts for New Bank Accounts Opened During the Year

Observation

As a result of our confirmation of bank accounts, we identified one new account opened during the year; however, a general ledger account had not been created with respect to this bank account. If a general ledger account has not been created for a bank account, staff are unable to monitor the activity in that bank account.

Recommendation

The City should implement a formal procedure for opening new bank accounts that includes the creation of a corresponding general ledger account.

Management Comments

We agree. The City of Toronto does have a process in place that includes the identification and need for a new bank account, its association with the City and the requirement for a corresponding general ledger account(s). The corresponding general ledger account is created upon receipt of confirmation that the account has been opened by the bank.

In this instance, the SDF&A Division set up a bank account for their petty cash fund instead of holding cash on site. Accounting Services has discussed this with SDF&A Division and the process will be changed to ensure that all bank accounts are set up in the general ledger.

Letter of Recommendations (continued)

2006 – Information Technology – SAP Program Change Documentation

Observation

Through our review of the SAP change management process, we noted that a central change management repository is not in place. As a result, evidence supporting the change management process is retained in various locations and with various individuals involved in the process, which increases the risk of key supporting documentation being lost or misplaced. This also increases the audit effort and ability to efficiently review the operation of the change management process. This risk did not result in an audit issue since we were able to obtain evidence to support all changes selected for review.

Recommendation

We recommend that change management documentation be retained in a centralized repository. We understand that the SAP Competency Centre is reviewing different options to address this item.

Management Comments

We agree with this recommendation. Implementation of SAP's change management tool, Solution Manager, began in Q4 2006. When fully implemented by the end of Q3 2007, Solution Manager will act as a centralized repository for all SAP change management documentation and approvals. The Solution Manager project will be coordinated with the City's information technology best practice initiative (Information Technology Infrastructure Library - ITIL) currently underway.

Letter of Recommendations (continued)

2006 – Information Technology - SAP Configuration – Review of Logs of Changes

Observation

Some SAP changes are required to be made directly in the production environment. Through our review of SAP configuration settings, we noted that SAP logging was enabled in September 2006 to log when this had occurred. At the time of review, a formal process to review and monitor these logs was not in place. Failure to monitor changes that have been made to sensitive configuration information increases the risk that unauthorized or inappropriate activity will not be detected or followed up.

Recommendation

A process to review changes to sensitive configuration tables should be implemented to ensure that changes are reviewed on a periodic basis for appropriateness.

Management Comments

We agree with this recommendation. The SAP Competency Centre is working with the business stakeholders to define and implement a process for reviewing and reporting changes to these sensitive tables by Q2 2007. The frequency for reviewing changes to these tables will be defined and will be driven by the specific requirements of each table (e.g. daily, weekly, monthly, or quarterly).

Letter of Recommendations (continued)

2006 – Toronto Police Services (“TPS”) - Information Technology - Employee Terminations

Observation

During our review we noted the following issues with the termination process of employees in the Peoplesoft application:

The monthly employee termination report sent by the Information Security group was not provided to the Enterprise Resources Management Systems Unit (ERMS) user administration group on a timely basis. For example, the listing of August 2006 employee terminations was not provided to the ERMS group until October 10, 2006. This is one of the key controls to ensure that user accounts are terminated in a timely fashion, and delays in removing terminated employees increases the risk of unauthorized or inappropriate access to the system.

Changes to user accounts (including account deletions) in the Peoplesoft application are not being logged. In addition, no other records are maintained to provide evidence of the timeliness of access revocation. As a result, we could not obtain evidence that Peoplesoft user accounts are removed on a timely basis.

Recommendation

Monthly termination listings should be provided to the ERMS user administration group on a timely basis and documentation of the review should be retained to provide evidence of the timeliness of user termination processes for all user accounts removed from the system.

In addition, management should review the feasibility of logging user account changes in the Peoplesoft application to provide an audit trail of activities performed and to provide evidence of timely user administration processing.

Management Comments

The ERMS Unit has made a request of the Unit Commander of the Professional Standards Unit to receive notification of terminations on a timely basis. Once the information is received, the proper action is promptly initiated by the ERMS Unit and records are kept within the unit that pertain to security changes.

The ERMS Unit does manually log the security changes and has noted the recommendation to change the PeopleSoft application to maintain a log of those changes. That request for a change to the application will be reviewed and assessed for possible implementation in the future.

Letter of Recommendations (continued)

2006 – TPS - Information Technology - Privileged Access to Time Recording Management System Application

Observation

During our review of users with privileged access to the Time Recording Management System [“TRMS”] application, we noted one user with “system administration” access to the TRMS application that was not required for his job function.

Recommendation

We recommend that this level of access be revoked from this user. In addition, we recommend that privileged access to the TRMS application be reviewed on a periodic basis to ensure that access of a privileged nature is restricted to authorized individuals in line with their job function.

Management Comments

The Information System Services Project Leader did not realize the level of access that was in place. The level of access has been reduced to the appropriate and required level, Admin Level and process will be put in place so this doesn’t happen again.

Letter of Recommendations (continued)

CARRYFORWARD OF PRIOR YEAR POINTS FROM AUDIT RESULTS

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, which 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 inter company 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.

2005 Management Comment

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

2006 Update

While staff have made improvements to increase the efficiency of the process, there are still a number of recurring manual entries and additional reclassification procedures performed. We recommend that staff continue to review and refine the process in order to minimize the number of recurring manual entries and reclassifications.

2006 Management Comments

The consolidation process is highly complicated due to the conversion required to translate ABC's statements to Public Sector Accounting Board (PSAB) statements. Accounting staff will continue to work with ABC's to ensure quality information is received on timely basis. In addition, accounting staff will continue reviewing the process in order to make additional improvements to streamline the consolidation process.

Letter of Recommendations (continued)

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.

2005 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.

2006 Update

We did not identify any similar instances in our testing in the current year and consider this matter complete.

Letter of Recommendations (continued)

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.

2005 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.

2006 Update

We did not identify any similar instances in our testing in the current year and consider this matter complete.

Letter of Recommendations (continued)

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.

2005 Management Comments

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.

2006 Update

Based on our communication with management, we understand that the Document Management System continues to be in the project planning and feasibility stages. As such the above noted discussion continues to be relevant upon system implementation and thus the point will remain open until that time.

2006 Management Comments

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.

Letter of Recommendations (continued)

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.

2005 Management Comments

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.

2006 Management Comments

The SAP Competency Centre now regularly receives the HR bi-weekly termination reports. As of Q4 2006, the SAP Competency Centre removes SAP access of terminated employees upon receiving the HR bi-weekly termination reports. The deletions are reported back to the business stakeholders for verification and confirmation. This procedure is being reviewed with the business stakeholders in Human Resources and Payroll and is expected to be formalized in Q1 2007.

The HR bi-weekly termination reports and monthly inactive user reports are also used for license management purposes. As a part of an overall SAP license management strategy, the SAP Competency Centre has recently conducted a review of all existing SAP named user licenses and implemented a regular monthly review of all new and deleted users.

Letter of Recommendations (continued)

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.

2005 Management Comments

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.

2006 Update

SAP logging was enabled in September 2006, however; at the time of review, a formal process to review and monitor these logs was not in place. We consider this point closed and have reported a new point in 2006 regarding the review of these logs. See “2006 – Information Technology – SAP Configuration – Review of Logs of Changes” above for further details.

Letter of Recommendations (continued)

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.

2005 Management Response

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

2006 Management Comments

The recommendations have been implemented and completed at the end of October 2006. The following specific enhancements to the password setting function in the system were implemented:

- A user must enter a password of between 6 - 8 characters in length. At least one number and alphabet character must be used in the password in any sequence.
- The applications will lock out an user after three unsuccessful log-in attempts using incorrect passwords. Once locked out, the user must contact the System and Innovation unit to have the account un-locked.
- Users are now prevented from re-using previously used passwords when changing their user account passwords. A table of previously used passwords is maintained in the application.

Letter of Recommendations (continued)

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.

2005 Management Comments

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.

2006 Update

We believe management has appropriately addressed this point in the current year and consider this matter complete.

Letter of Recommendations (continued)

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.

2005 Management Comments

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.

2006 Update

We believe management has appropriately addressed this point in the current year and consider this matter complete.

Letter of Recommendations (continued)

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

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

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.

2005 Management Comments

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

2006 Update

We understand this matter is still being resolved.

Letter of Recommendations (continued)

2006 Management Comments

This is one of two significant issues regarding Employee Benefits that was to be resolved by the City and TCHC. A report was approved by Council September 25, 26, 27 regarding the release of Statutory Entitlement Funds for Former Metropolitan Toronto Housing Authority Employees to Toronto Community Housing Corporation resulting in \$14 million transfer of funds from City to TCHC. Now that this matter has been resolved, both the City and TCHC have agreed to focus their efforts in 2007 on resolving the issue surrounding the funding strategy for the long term future employee benefit liability associated with the former Metro Housing employees and TCHC employees.

TCHC is currently preparing information to be shared with the City and will form the basis of the discussion.

Letter of Recommendations (continued)

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.

2005 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.

2005 Management Comments (continued)

An “Information Technology Governance and Organizational Design Review” is underway in 2006. This exercise will include a review of the accountability, roles and responsibilities for the SAP Competency Centre and the key business stakeholders and process owners in the operation and support of the SAP 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.

Letter of Recommendations (continued)

2003 – INFORMATION TECHNOLOGY – SAP Information Security – updated for current status (continued)

2006 Management Comments

We agree that access to IT functions should be segregated from business functions and that a number of business users outside of the SAP Competency Centre currently do have high level access to the SAP production system. The use of IT functions by these individuals is limited to the functions allowed in the so-called “emergency” profiles. When a business user requires high level access to IT functions in SAP due to an operational support need, the emergency profile is assigned to the user and the activities performed are logged. Once the issue is resolved, the emergency profile for the user is revoked.

The SAP Competency Centre monitors all usage of these emergency profiles and compares them to the activity log. All discrepancies are reported and investigated. We continue to monitor security profiles that are developed by business users to ensure IT functions are not added to already-established business user profiles. The need for high level access by business users will continue to be reviewed with the process owners.

Letter of Recommendations (continued)

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

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

2000 – Finance - Environmental Liabilities

Observation

There was a point in the 1997 Management Letter for Metro that addressed the fact that there were no policies on identifying, quantifying and recording potential environmental liabilities. The point made in 1997 was the fact that “Metro had not developed accounting policies regarding the recording and reporting of environmental remediation costs. Such costs relate to the amount of future resources required to bring environmentally damaged sites to a condition where they comply with environmental laws and regulations.” As per our discussions with Finance staff at the amalgamated City, there is still no development in this area. Not having such a policy makes it difficult for the City to do proper long term planning for funds that should be set-aside in reserves etc.

Recommendation

It is recommended that formal policies for identifying, quantifying and recording potential environmental liabilities be created.

2005 Management Comments

It is important to note that there are no current requirements under public sector accounting rules for the City to either cost or fund environmental liabilities. As such, the City’s focus is on the assessment of future environmental risks and the development of appropriate funding strategies to manage those risks. On that basis, the City’s initiatives have been divided into two primary areas:

- (i) Landfill sites: The City is required under Provincial legislation to manage environmental risks associated with former landfill sites. In 2005, Council approved a funding strategy to provide adequate care of former landfills over the next 40 years, including the establishment of a reserve fund. However, the current fiscal situation has meant that this funding has been deferred beyond 2006.
- (ii) Other environmental risk exposures: Under the City’s new organizational structure, responsibility for environmental issues falls within Deputy City Manager Fareed Amin’s cluster. Work is proceeding in conjunction with Corporate Finance and other City divisions on the quantification of environmental remediation costs on certain properties as a long term project. Progress toward the quantification of the potential costs of remediation of those properties and associated funding strategies will be reported periodically.

Letter of Recommendations (continued)

2000 – Finance - Environmental Liabilities (continued)

2006 Management Comments

- (i) No change.
- (ii) The Public Sector Accounting Board of the Canadian Institute of Chartered Accountants has approved Environmental liabilities as one of the projects to be implemented in the near future. When the new standards are issued, the City will take steps to ensure that the City's reporting is in compliance with these new standards.

Letter of Recommendations (continued)

2001 – Information Technology - Disaster Recovery Planning

Observation

The City's reliance on information technology continues to increase. We noted, however, that the City has not yet developed a formal, organization-wide, recovery plan for critical systems in the event of a computer-related disaster. In the event of a disaster, the City would have to carry out ad hoc recovery procedures thereby increasing the risk of a significant disruption to the City's operations.

We recognize that the City is about to commence a Business Impact Analysis (BIA), which will assist in determining minimum recovery timeframes for critical business systems. The next phase in this process will be to develop the plan to meet the requirements determined by the BIA.

Recommendation

We support the City's initiatives in this area and suggest that a full Disaster Recovery Plan (DRP) be put in place as soon as possible.

2005 Management Comments

Phase 1 of the Disaster Recovery Plan - Business Impact Assessment, was completed in 2005. This report recommended as a top priority that a Disaster Recovery Site be established that would provide capability for redundancy to reduce systems risk.

A Disaster Recovery Centre is currently being constructed in conjunction with Toronto Water. We will be moving equipment into this facility commencing in the 2nd quarter of 2006.

A detailed 5 year plan and budget will be developed over the course of 2006. This plan will identify the priorities for acquiring backup infrastructure for the Disaster Recovery site and other investments required to reduce or mitigate the risks from disasters. This plan will provide progressively greater disaster recovery capabilities for the City's critical business systems.

2006 Update

We recognize that the City obtained a completed Business Impact Analysis (BIA), which will assist in determining minimum recovery timeframes for critical business systems. The next phase in this process will be to develop the plan to meet the requirements determined by the BIA. We support the City's initiatives in this area and suggest that a full Disaster Recovery Plan be put in place.

Letter of Recommendations (continued)

2001 – Information Technology - Disaster Recovery Planning (continued)

2006 Management Comments

Currently the Technology Disaster Recovery Plan project is underway and is achieving key milestones. In 2006, a project charter was developed and approved by Senior Management. The charter addresses the findings in the BIA and provides a roadmap for achieving these requirements. Secondly, construction of an alternate Data Centre for disaster recovery is underway and will be completed in the third quarter of 2007. Critical infrastructure needed for doing restores at this site has been purchased and will be in place by fourth quarter of 2007. This initiative is in-line with the City's current disaster recovery strategy of restoring data from backup tapes. Third, an RFP for Professional Services has been created and will be released early in 2007. These services will assist the DR team in the creation of a formalized I&T disaster recovery plan, as well as providing architectural expertise for disaster recovery solutions. In summary, the Technology Disaster Recovery Plan project is underway and is meeting milestones.

A brief summary of planned deliverables for key financial systems is summarized below:

- Mainframe – 2007 – secondary network connection to EDS to be installed at the DR site.
- SAP – 2007 – the DR team will meet with the application owners to understand their needs and create an integration plan.
- SAP – 2008 – necessary infrastructure and application recovery plan in place.
- Tax and Water – 2008 – necessary infrastructure and application recovery plan in place.
- Telecomm Management System (TMS) – 2008 - necessary infrastructure and application recovery plan in place
- Class – 2008 – necessary infrastructure and application recovery plan in place.
- Parking Tags – 2009 - necessary infrastructure and application recovery plan in place.
- Municipal Licensing – 2010 - necessary infrastructure and application recovery plan in place.
- Children Services Budgeting System - 2010 - necessary infrastructure and application recovery plan in place.
- Capital Budgeting System - 2010 - necessary infrastructure and application recovery plan in place.

As with SAP, the DR team will meet with each application owners the year before the set deliverable date in order to create an application integration plan.

The DR team believes the above initiatives can be met within the specified timelines. However, deliverables are subject to annual budget cash flow approval and may be changed when required. By achieving the above deliverables, the City will mitigate against disruption of City operations in the event of a computer-related disaster at the City's main data centre.

Letter of Recommendations (continued)

2001 – TPS - Information Technology – Disaster Recovery Planning

Observation

TPS's reliance on information technology continues to increase. We noted, however, that Police Services has not yet developed a formal, organization-wide, recovery plan for business support systems in the event of a computer-related disaster. In the event of a disaster, the Service would have to carry out ad hoc recovery procedures, thereby increasing the risk of a significant disruption to the Service's operations.

We understand that the critical services, including Dispatch and '911', have recovery and continuity plans in place.

Recommendation

TPS should consider developing continuity and recovery plans for business support systems. This process should begin with a "business impact analysis" as a basis for determining the timeframe within which critical business processes need to be restored. Disaster recovery plans should then be developed to allow TPS to restore its information technology on a timely basis and to ensure minimum basic functions are carried out in the interim.

2005 Management Comments

Data is currently maintained offsite on backup tapes which are periodically rotated. The TPS has an approved three year plan to populate its systems at a Disaster Recovery Centre and have classified all current systems as to their importance and impact to the organization. All new systems which are deemed to be Class "A" (critical) will be targeted to run simultaneously at both the Disaster Recovery Centre and the normal Operations Centre. Hardware is currently being installed at the Disaster Recovery Centre and the operation of the architecture and Class 'A' systems at both sites is scheduled to proceed to mid 2006. Class 'B' and 'C' systems are currently being evaluated and a decision on the best method of providing recovery facilities is expected to be implemented in 2006.

2006 Update

We understand that a disaster recovery project is currently underway and will concentrate on those applications and supporting infrastructure deemed 'Class A' systems. We support this initiative and encourage management to ensure that plans for the 'Class B' systems (including the financial systems) are developed to allow Toronto Police Services to restore its information technology on a timely basis in the event of a disruption of service.

2006 Management Comments

The Business Units associated with the Class B applications have reviewed the Disaster Recovery plans. Class B systems would be returned to full service over the course of one to four weeks. The Business Units have confirmed that during the period, transactions would be processed manually and any backlog can be managed.

Letter of Recommendations (continued)

2001 – TPS - Information Technology – Information Security

Observation

TPS recognizes the importance of maintaining a high level of security over its administrative computer systems. We noted, however, that the password controls around TPS's computer environment might not adequately restrict unauthorized access to the systems and data. We have provided management with our technical comments by computer system. Also, we noted that there is no review of the Windows NT security logs for detection of invalid access attempts or other unusual activity.

We acknowledge the difficulties in standardizing and enforcing strict password controls for such a large and disparate computing environment, and we understand the need to balance preventative security measures with the operational necessities of swift access to computerized information faced by law enforcement officers. We understand that the IT department has been investigating methods of improving computer access security, such as biometric single sign-on.

Recommendation

We recommend that consideration be given to improving information security across all of TPS's administrative computer systems by improving password security at the network, operating system and application level. This would involve enforcing a minimum password length for all applications, a lockout after repeated invalid access attempts, and regular password ageing. We also recommend that NT Security logs be reviewed in order to detect potential invalid access attempts, or other unusual activity.

2005 Management Comments

All logs for the login system are captured centrally and used for investigation and audit purposes. The migration from the current NT environment to an XP environment will be completed by March 2006 and will enable system and application authorization and user authentication processes to be facilitated with Active Directory, a component of the XP operating system. Strong authentication requirements will be implemented late in the year with the development of a password policy which will specify the minimum length of password, password aging period and a limited period to login in order to prevent unauthorized access. This will be completed by the end of 2006.

2006 Update

This matter was unresolved as of the completion of our audit field work date.

2006 Management Comments

2 Factor Authentication has now been implemented and meets all of the recommended requirements regarding length of password, password history, password aging and establishing an account lockout policy.

Letter of Recommendations (continued)

2003 – Finance/WES – Deposits

Observation

Works and Emergency Services (“WES”) Transportation and WES Technical Services both accept deposits from builders and municipalities for capital and development projects affecting roadways or sidewalks. Our understanding is that these deposits are refundable once the City has inspected the site and determined that the work has been completed to the City’s satisfaction. The balance with respect to these accounts has continued to accumulate in the last few years with minimal refunds being issued. We understand that, although understaffing in completing inspections causes some delays in processing refunds, the primary reason for the increase in the amount of deposits held is due to builders and municipalities forgetting about the deposits and never claiming them back.

Recommendation:

We recommend that a policy be developed as to the length of time that the City will hold deposits within accounts payable before proceeding to write them off to income within the City’s records.

2005 Management Comments

A report has been prepared and is being tabled for consideration by members of Works Committee in March 2006 on the harmonization of the Municipal Road Damage Guarantee process. This report addresses issues with respect to inspections, follow up procedures on unclaimed deposits and the length of time deposits are held before accounting action is taken on the unclaimed amounts.

2006 Update

It is our understanding that during 2006 efforts were made by the City to advise the public as to the existence of these deposits as well as the procedures to be followed for claiming a refund. Based on our discussions with City staff as well as the movement in the account balance year over year we noted that the response rate for refunds were not significant.

We also understand that as of May 2006 it was determined by the Works Committee that all deposits would be analyzed and any non-refunded deposits older than 2003 would be transferred to a reserve fund. Based on our observation, as at the end of fiscal 2006 this had yet to occur.

2006 Management Comments

City Council, at its meeting on May 23, 24 and 25, 2006, adopted Works Committee Report 2, Clause 1a containing staff recommendations in the report (December 8, 2005) from the General Manager, Transportation Services respecting the harmonization of the Municipal Road Damage Deposits process.

Letter of Recommendations (continued)

2003 – Finance/WES – Deposits (continued)

2006 Management Comments (continued)

By-law No. 462-2006 was passed amending Chapter 743 of the City of Toronto Municipal Code pertaining to the Use of Streets and Sidewalks. The new policy includes a provision for the disposition of deposits after a two year period (or up to four years if an extension is requested). In addition, the City posted notices in September 2006 to advise the public of unclaimed deposits prior to 2003 that appear to have been abandoned. After this final attempt to return the deposits to the legitimate owners, the new policy provides for the transfer of unclaimed funds to the Roads and Sidewalk Reserve Fund to be used as a funding source for road and sidewalk maintenance and repairs.

Letter of Recommendations (continued)

2004 – Former North York Fence Deposits

Observation

This account within SAP accumulates deposits required to set up fences on the property surrounding construction sites. We understand this by-law was discontinued in 2000 and the balance in the account represents money for which refunds have yet to be requested. The balance in this account has remained consistent with prior years given few appear to be aware that these amounts are refundable to them.

Recommendation

We recommended that management establish a policy of taking these deposits into income in a predetermined and consistent manner once efforts to identify to whom these amounts are refundable have been exhausted.

2005 Management Comments

With the discontinuation of the bylaw in 2000, fence deposits are no longer required. A review of Building Division records was completed in 2005 and a process for owners to claim their deposits is being developed. Refunds to depositors will be initiated in 2006 where required.

2006 Update

As part of testing performed it was noted that an insignificant amount of refunds had been issued to depositors during 2006 and a process for claiming deposits had yet to be developed.

2006 Management Comments

Building Services staff will submit a report in 2007 to Council with recommendations on clearing the deposits and a refund procedure. If recommendations are approved, notification will be sent to homeowners and the refund process will be initiated.

Letter of Recommendations (continued)

2004 – Vacation Accrual Days Not Recorded in SAP

Observation

Employees' unused vacation balances have typically been uploaded into SAP up to a week or so in advance of year end, which has resulted in vacation entitlements being overstated for vacation days taken between this upload date and December 31. As staff use the most recent uploaded balances in SAP to estimate and record the accrual for unused vacation at year-end, the accrual was overstated. Management has adjusted for this overaccrual in the consolidated financial statements and we have reviewed and concur with the adjusted balance for unused vacation at year-end.

Recommendation

We understand a new system to track employee's vacation entitlement directly within SAP is scheduled to be implemented and in use in March 2006, which will prevent this cutoff error in the future.

2005 Management Comments

This issue relates to the TES time and attendance system, still in use for some City employee groups. A TES Replacement Project migrating this data to SAP is currently underway and will be operational in March 2006. The 2005 vacation accrual produced by this system has been adjusted by a manual journal entry in order to reflect an accurate vacation accrual in the 2005 consolidated financial statements.

2006 Update

We did not identify any similar instances in our testing in the current year and consider this matter complete.



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