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Mr. Martin Willschick
Manager, Treasury Services
City of Toronto
Toronto City Hall
100 Queen Street West, 5th Floor, East Tower
Toronto, ON M5H 2N2

September 3, 2009

Dear Mr. Willschick:

Our examination of the City of Toronto's compliance with governing legislation and the City of Toronto's Investment Policy and Procedures, dated May 2004 for the year ended December 31, 2008 has been completed. As part of our examination of the compliance of the City of Toronto (the "City") with its Investment Policy and Procedures (the "policy"), we studied and evaluated the City's system of internal control to the extent we considered necessary under Canadian generally accepted auditing standards. This was done to establish a basis for reliance on the system in determining the nature, timing and extent of our auditing procedures necessary to enable us to express an opinion on the City's compliance. The study was not designed to determine whether the City's system of internal control is adequate for management's purposes.

Accordingly, our examination of the City's compliance, including our study and evaluation of the system of internal control, will not necessarily disclose all conditions requiring attention because the audit employs, as is customary, selected tests of accounting records and related data. However, during our examination, we have discovered opportunities for improvements in certain of the City's internal controls. The attached memorandum of recommendations is enclosed for your information.

The comments outlined in this memorandum concern controls and areas for potential improvements and are not intended to reflect in any way upon the City's personnel. The purpose of this memorandum is to document our observations and recommendations arising from the 2008 audit, along with management's responses to these observations. Our recommendations do not repeat audit recommendations made by the Auditor General in the Auditor General's Treasury Management Review. We would like to take this opportunity to thank you and your staff for the assistance provided during the course of this year's audit.

Should you wish to discuss the memorandum in further detail, we would be pleased to do so.

Yours sincerely,

A handwritten signature in cursive script that reads 'Ernst & Young LLP'.

Chartered Accountants
Licensed Public Accountants

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2008 Points**1.0 Compliance with Investment Policy and Procedures****2008 Observations**

During our testing of the City's compliance with its policy and procedures, we observed deviations with respect to the following criteria:

[a] Minimum Credit Ratings

We observed that one investment purchase in the Bond Fund during the year, which was a City of Quebec unrated bond, did not meet the minimum credit rating.

[b] Approved Credit Ratings

We observed deviations between issuer's ratings in the system versus issuer's published ratings as a result of the system's ratings not being monitored and updated on a timely basis. We understand that internal checks are done on a transaction by transaction basis, which should prevent the City from purchasing investments that are not within the approved credit ratings, however, we believe the issuer's ratings as recorded in the system is a key internal control to prevent the City from making investments that are not permitted by its investment policy. We extended our audit procedures as a result of the internal control weakness identified and did not identify any compliance deviations with the policy.

2008 Recommendations

We recommend that the City establish internal controls that prevent purchases of investments that do not meet the minimum credit ratings.

2008 Managements' Comments**[a] Minimum Credit Ratings**

Management quickly sold the investment once it was decided that it did not meet the policy.

[b] Approved Credit Ratings

Following Ernst & Young's feedback based on the samples tested, management acted immediately and implemented a new internal control for staff to perform a full reconciliation of the FIDM system (internal system) versus that actual issuer's published ratings 3-4 times a year, with paper record, in addition to the ongoing update of credit ratings as upgrade/downgrade/withdrawal occurs.

**2007 Points****1.0 Limits per System are Inconsistent with the Policy****2007 Observations**

During our testing of the City's compliance with its policy, we observed that there were a number of inconsistencies between the City's system and its policy with respect to the maximum investing holding term limits and the maximum holding percentages by issuer limits.

2007 Recommendations

We recommend that the City review its policy with respect to investment holding terms, and investment holding percentages by issuer and consider whether all are appropriately reflected and updated in the system.

2007 Managements' Comments

With reference to the audit comment above, at the end of 2007 management reviewed the holding term limits, % holding limits and credit rating limits, and developed a spreadsheet that outlined new limits for these areas for both General Funds & Sinking Funds. This went before the Sinking Fund Committee & Investment Advisory Committee on December 10, 2007 and was approved to be retroactive until January 1, 2007. However, it was not scheduled to go before the council for approval until May 2008, which is after the completion date of the compliance engagement.

2008 Update

The Investment Policy has not been updated for the above.

2008 Managements' Comments

Management has introduced a new investment policy effective February 28, 2009 which was approved by Council and will address these issues.

2.0 Grouping per System is Inconsistent with the Policy

2007 Observations

During our testing of the City's compliance with its policy, we observed that there were inconsistent groupings of investments between the system and the policy.

[a] Grouping of School Board Investments

We observed that there were cases where School Board investments that should have been grouped with municipalities or provinces were incorrectly grouped within the asset backed category. This affects the system appropriately calculating that the City is within the policy limits established.

[b] Grouping of Asset Backed Securities

We also observed that there were some cases where "Other" & "Trust Com" were separated into two different groups yet they were both composed of asset back securities. The policy indicates that all asset backed securities are to be grouped together in order to determine whether the City meets the total holding limits established.

2007 Recommendations

We recommend that the City review its policy with respect to grouping of investments and consider whether all are appropriately reflected in the system.

2007 Managements' Comments

Staff are reviewing the policy regarding the grouping of investments and it will be included in the 2008 Investment Policy. It must be noted that the City does not invest in any sub-prime mortgage or foreign securities. Although the City's policy does allow for investment in asset-backed commercial paper (ABCP) with an AAA credit rating, the City's holdings were 2% of the portfolio's value at the end of 2007 and were issued by the five major Canadian chartered banks and backed upon higher-quality assets such as bank credit card receivables and not sub-prime securities.

2008 Update

Changes were made to address the two issues identified in 2007, however further issues were identified in 2008 in relation to these issues, specifically;

[a] Grouping of School Board Investments

We observed that School Board Investments are not separated out from other investments as the policy dictates, which results in the system being unable to detect if the City's holdings are greater than allowed by the policy.

[b] Grouping of Asset Backed Securities

We observed that Canada Housing Trust, which is guaranteed by the government of Canada was grouped in the Asset Backed Securities section of the system when it should have been grouped in the Canada section. This results in the system being unable to detect if the City's holdings are greater than allowed by the policy.

2008 Managements' Comments

Management has introduced a new investment policy effective February 28, 2009 which was approved by Council and will address these issues.

Follow up of 2004 Point**1.0 Investment Policy Monitoring Parameters not Explicitly Stated*****2004 Observation***

We observed that the Investment Policy does not explicitly state that the 4%, 5% and 6% Sinking Funds are evaluated on a group basis when monitoring compliance with maximum investment holding percentages by issuer limits included in the Policy, and not on an individual fund basis.

2004 Recommendation

We recommend the policy be revised to clearly articulate that the maximum investment holding percentages by issuer limits for Sinking Funds refer to the group of funds, thereby removing any confusion on the matter.

2004 Managements' Comments

Management intends to revise the policy to incorporate the treatment already followed and generally accepted as the basis for evaluation of all of the portfolios. Sinking Funds have only been separated for actuarial purposes and for all other purposes are measured on a consolidated basis.

2005 Update

No changes have been made to Investment Policy in the current year. As a result, the Investment Policy has not been updated for the above.

2005 Managements' Comments

Due to the new City of Toronto Act and the investment regulations accompanying the new Act being effective as of January 1, 2007, management will be introducing a new investment policy for Council approval that will address these issues and incorporate E&Y's comments.

2006 Update

No changes have been made to Investment Policy in the current year. As a result, the Investment Policy has not been updated for the above.

2006 Managements' Comments

Due to the new City of Toronto Act and the investment regulations accompanying the new Act being effective as of January 1, 2007, management will be introducing a new investment policy in 2008 for Council approval that will address these issues and incorporate Ernst & Young's comments. As the result of the Auditor General's Treasury Management Review, an Investment Advisory Committee has been established and will review the approved list and recommend any changes for Council's approval.

2007 Update

The Investment Policy has not been updated for the above.

2007 Managements' Comments

Management will be introducing a new investment policy in 2008 for Council approval that will address these issues and incorporate Ernst & Young's comments and will include as changes as necessitated by the *City of Toronto Act* and the provincial regulations that has been adopted under the Act.

2008 Update

The Investment Policy has not been updated for the above.

2008 Managements' Comments

Management has introduced a new investment policy effective February 28, 2009 which was approved by Council and will address these issues.

Follow up of 2003 Points

1.0 Compliance with Investment Policy and Procedures

2003 Observations

During our testing of the City's compliance with its policy, we observed deviations with respect to the following criteria:

[c] **Maximum Investment Holding Terms Limits Exceeded**

We observed the maximum terms being exceeded, namely in the bond fund, on a number of occasions throughout the year.

[d] **Maximum Investment Holding Percentages by Issuer Limits Exceeded**

We observed the maximum holding percentages by issuer being exceeded. These exceptions were observed across all funds at various times throughout the year.

[e] **Investment in non-Approved Issuers**

We observed that the City had invested in one issuer not included in the policy.

2003 Recommendations

We recommend that the City review its policy with respect to investment holding terms, investment holding percentages by issuer, approved issuers and credit rating parameters and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding and percentages by issuer terms from being exceeded and to prevent investments in issuers who have not been approved.

2003 Managements' Comments

The City's previously approved investment policy limits were established at amalgamation. The City's investment program and policies have developed over the years during which time changes to governing legislation and portfolio objectives have occurred. These changes identified areas where amendments to the existing policies were imminent (i.e. eligible investments and issuer portfolio and term limits).

With reference to audit comment [c] above, the City's investment policies listed several municipalities deemed eligible based on credit ratings received by one of the four major credit rating agencies which included Moody's Investor Services. As an oversight, the general category for all other Canadian municipalities referred to credit rating agencies CBRS and DBRS only. The issuer in question is a Canadian municipality which had been rated only by Moody's Investor Services and technically was not in compliance for this reason. Given the Moody's credit rating, had it been compared to an equivalent level with CBRS or DBRS, this issuer would have been considered appropriate.

The recently approved investment policy reflects changes that have been recognized over the past several years and provides confirmation that all non-compliance occurrences reported in this review have been rectified.

2004 Update

During our testing of the above in 2004, we observed deviations with respect to the following criteria:

[a] Maximum Investment Holding Terms Limits Exceeded

We observed the maximum terms being exceeded in the bond fund and the Toronto trust fund on a number of occasions throughout the year.

[b] Investment in non-Approved Issuers

We observed that the City had invested in one issuer not included in the policy and had invested in two Schedule III banks that were included in the Policy as Schedule II banks.

2004 Recommendations

We recommend that the City review its policy with respect to investment holding terms and approved issuers and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding terms from being exceeded and prevent the investment in non-Approved issuers.

2004 Managements' Comments

With reference to audit comment [a] above, one security was purchased by the City of Toronto in 1984, and was inherited as part of the amalgamation process in 1998. The uniqueness of this one-time investment did not warrant a policy limit term of 50 years being established to ensure compliance was met for one purchase which was not to be replicated again. It was deemed more prudent to allow for this one exception to the policy limits than to expose the portfolio to a potential investment in this bank name beyond the reasonable 10 year term limit.

A second security was purchased as a new issue and settled one day before the annual anniversary date of the maturity. The result is a long first coupon and technically for 1 day was in breach of our policy limit. On the following day, this security would have had a maturity date that would be in compliance with the City's approved policies. Unfortunately, the security would have no longer been available for purchase.

With reference to audit comment [b] above, the City's investment policies are derived from the Municipal Act Investment Legislation - eligible investments. Our policies reference many specific issuer names however the list of all potential eligible issuers was much too extensive to incorporate into the document itself. As in this case, there will be instances where an eligible issuer is not specifically listed on our schedule. By including a limit for each individual issuer group our intent was to provide the flexibility to add additional issuers to the respective categories as needed providing the credit rating criteria was met.

We execute money market trades with Deutschebank and Citibank under the verbal guidance from the Ministry that this issuer was not intended to be excluded from the Municipal Act eligible investments. Although the product is technically eligible under our commercial paper category given

this issuer's A-1+ credit rating the correct answer is we continue to invest in this highly rated issuer as it will be grouped with the Schedule II Bank limitations even if it is given a Schedule III rating in the Bank Act.

2005 Update

During our testing of the City's compliance with its policy, we observed deviations with respect to the following criteria:

[a] **Maximum Investment Holding Terms Limits Exceeded**

We observed the maximum investment holding term limits being exceeded, namely in the provincial and municipal part of bond fund and the Toronto Trust Fund, at various times throughout the year.

[b] **Maximum Investment Holding Percentages by Issuer Limits Exceeded**

We observed the maximum investment holding percentages by issuer limits was exceeded by one fund during the year.

[c] **Credit Rating Parameters**

We observed that two investments were held in one issuer that was delisted in 2005.

2005 Recommendations

We recommend that the City review its policy with respect to investment holding terms and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding terms and percentages by issuer from being exceeded and prevent the investment in issuers that do not meet the Investment Policy's credit rating parameters.

2005 Managements' Comments

Due to the new City of Toronto Act and the investment regulations accompanying the new Act being effective as of January 1, 2007, management will be introducing a new investment policy for Council approval that will address these issues and incorporate E&Y's comments.

2006 Update

During our testing of the City's compliance with its policy, we observed deviations with respect to the following criteria:

[a] **Maximum Investment Holding Terms Limits Exceeded**

We observed the maximum investment holding term limits being exceeded, namely in the provincial and municipal part of bond fund and the Toronto Sinking Funds and Toronto Trust Fund, at various times throughout the year.

[b] Maximum Investment Holding Percentages by Issuer Limits Exceeded

We observed the maximum investment holding percentages by issuer limits was exceeded in the Sinking Funds during the year.

2006 Recommendations

We recommend that the City review its policy with respect to investment holding terms and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding terms by issuer from being exceeded.

2006 Managements' Comments

Due to the new City of Toronto Act and the investment regulations accompanying the new Act being effective as of January 1, 2007, management will be introducing a new investment policy in 2008 for Council approval that will address these issues and incorporate Ernst & Young's comments. As the result of the Auditor General's Treasury Management Review, an Investment Advisory Committee has been established and will review the approved list and recommend any changes for Council's approval.

2007 Update

During our testing of the City's compliance with its policy, we observed deviations with respect to the following criteria:

[c] Maximum Investment Holding Terms Limits Exceeded

We observed the maximum investment holding term limits being exceeded, namely in the provincial and municipal part of bond fund and also in the Toronto Trust Fund, at various times throughout the year.

[d] Maximum Investment Holding Percentages by Issuer Limits Exceeded

We observed the maximum investment holding percentages by issuer limits was exceeded in the Sinking Funds various times during the year and also in the Bond Fund.

2007 Recommendations

We recommend that the City review its policy with respect to investment holding terms and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding terms by issuer from being exceeded.

2007 Managements' Comments

Management will be introducing a new investment policy in 2008 for Council approval that will address these issues and incorporate Ernst & Young's comments and will include as changes as necessitated by the *City of Toronto Act* and the provincial regulations that has been adopted under the *Act*.

2008 Update

During our testing of the City's compliance with its policy, we observed deviations with respect to the following criteria:

[e] Maximum Investment Holding Terms Limits Exceeded

We observed the maximum investment holding term limits being exceeded, namely in the Bond Fund and also in the Toronto Trust Fund, at various times throughout the year.

[f] Maximum Investment Holding Percentages by Issuer Limits Exceeded

We observed the maximum investment holding percentages by issuer limits was exceeded in the Sinking Funds at various times during the year.

2008 Recommendations

We recommend that the City review its policy with respect to investment holding terms and consider whether it is appropriate to revise the policy to incorporate current investment practices. The City should also establish internal controls that prevent the approved maximum investment holding terms by issuer from being exceeded.

2008 Managements' Comments

Management has introduced a new investment policy effective February 28, 2009 which was approved by Council and will address these issues.