

# *City of Toronto*

*Report to the Audit Committee  
for the year ended  
December 31, 2010*

**Prepared as at  
June 20, 2011**



June 20, 2011

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

Dear Members of the Audit Committee:

We have substantially completed our audit of the consolidated financial statements of the City of Toronto (the City) for the year ended December 31, 2010 and propose to issue an unqualified report on those financial statements, pending resolution of the outstanding items outlined on page 1. Our draft auditor's report is included as Appendix A.

We have issued the accompanying report to assist you in your review of the consolidated financial statements. It includes an update on the status of our work as well as a discussion of the significant accounting and financial reporting issues dealt with during the audit process.

The matters raised in this report are only those that have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. This report has been prepared solely for the use of the Audit Committee, Council and management, 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.

We propose to review the key elements of this report at the upcoming meeting and discuss our key findings with the Audit Committee.

We would like to express our sincere thanks to management and staff of the City who have assisted us in carrying out our work and we look forward to our meeting on July 5, 2011. Should you have any questions or concerns prior to the Audit Committee meeting, please do not hesitate to contact me in advance.

Yours very truly,

*PricewaterhouseCoopers LLP*

Cathy Russell  
Partner  
Audit and Assurance Group

cc: Mr. J. Pennachetti, City Manager  
Mr. C. Weldon, Deputy City Manager & Chief Financial Officer  
Mr. J. Griffiths, Auditor General

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\*PwC\* refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

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<i><b>Index</b></i>	<i><b>Page</b></i>
1. Executive summary .....	1
2. Significant audit, accounting and financial reporting matters .....	4
3. Summary of unadjusted and adjusted misstatements .....	13
4. Other required communications .....	14
5. Internal control recommendations .....	15
6. 2010 audit fees .....	16

## Appendices

**Appendix A: Draft auditor's report**

**Appendix B: Summary of unadjusted and adjusted misstatements**

**Appendix C: Draft management representation letter**

**Appendix D: Independence letter**

**Appendix E: Internal control recommendations**

**Appendix F: Public Sector Accounting - What's new?**

The matters raised in this and other reports that will flow from the audit are only those that have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising and, in particular, we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted, as the report has not been prepared for, and is not intended for, any other purpose. Comments and conclusions should only be taken in context of the financial statements as a whole as we do not mean to express an opinion on any individual item or accounting estimate.

## 1. *Executive summary*

### a. Status of the audit

We have substantially completed our audit of the 2010 consolidated financial statements. Our audit report will be issued once we receive and have completed our audit work related to the outstanding items noted below.

Our audit has been performed substantially in accordance with the plan and timeline previously communicated to you.

The following items will need to be completed/received prior to the issuance of our opinion. We will provide an update on the status of these items at our upcoming meeting.

<b>Outstanding items as at June 20, 2011</b>	<b>Status as at July 5, 2011</b>
i. Receipt of one outstanding bank confirmation	
ii. Responses to our legal confirmation letters (4) from external legal counsel	
iii. Receipt of certain supporting documentation in order to complete our audit testing related to deferred revenue, other liabilities, funding from other governments, certain expenses and environmental provisions at the Toronto Portland's Corporation	
iv. Completion of audit procedures related to the review of the note disclosures in the consolidated financial statements including obtaining supporting documentation/schedules for certain disclosures.	
v. Completion of subsequent events procedures to the date of our audit opinion	
vi. Receipt of signed management representation letter	
vii. Approval of the financial statements by the Audit Committee	

## b. Key issues for discussion

The following is a summary of the key audit and financial reporting issues we discussed with management during the audit. Further details on each issue can be found within this document. (All amounts are in thousands of dollars)

	<b>Issue</b>	<b>Summary discussion</b>	<b>For further reference</b>
i.	Significant audit, accounting and financial reporting matters	<ul style="list-style-type: none"> <li>• Section 2 of our report discusses the areas that we focused on in conducting our audit and significant accounting matters which we believe should be brought to your attention. These areas comprise the following:               <ul style="list-style-type: none"> <li>i. Employee benefits – TTC Pension Fund Society;</li> <li>ii. Employee benefits – Other pension and non-pension benefit plans;</li> <li>iii. Significant estimates and areas of management judgment;</li> <li>iv. Revenue recognition;</li> <li>v. Contingent liabilities (property and liability claims);</li> <li>vi. Landfill closure and post-closure costs for active and inactive landfill sites;</li> <li>vii. Financial statement close process;</li> <li>viii. Province of Ontario loan; and</li> <li>ix. Management override of controls</li> </ul> </li> </ul>	Page 4
ii.	Summary of adjusted and uncorrected misstatements	<ul style="list-style-type: none"> <li>• During our audit of the consolidated financial statements, we tracked individual misstatements in excess of \$4.6 million, representing 5% of overall materiality (set at the planning stage of the audit). Unadjusted and adjusted misstatements greater than this threshold are itemized in Appendix B.</li> <li>• As detailed in Appendix B, net operating surplus is overstated by \$6 million in the current year as compared to overall materiality of \$92 million.</li> <li>• In our opinion, the consolidated financial statements, taken as a whole, are free of material misstatement.</li> </ul>	Appendix B

	<b>Issue</b>	<b>Summary discussion</b>	<b>For further reference</b>
iii.	Control deficiencies	<ul style="list-style-type: none"><li>• While completing our audit procedures we identified certain internal control recommendations for management's consideration which are itemized in Appendix E.</li></ul>	Appendix E
iv.	Independence	<ul style="list-style-type: none"><li>• We confirm that we are independent of the City as at June 20, 2011, and our independence letter can be found in Appendix D.</li></ul>	Appendix D
v.	Fraud	<ul style="list-style-type: none"><li>• No instances of fraud were noted when completing our audit procedures.</li></ul>	
vi.	Management representations	<ul style="list-style-type: none"><li>• Under Canadian Auditing Standards, we are required to inform you of the representations we are requesting from management. A copy of the draft management representation letter is included in Appendix C.</li></ul>	Appendix C

## 2. Significant audit, accounting and financial reporting matters

The preparation of the consolidated financial statements under Canadian generally accepted accounting principles (GAAP) requires management to select accounting policies as well as make critical accounting estimates and disclosures that involve significant judgment and measurement uncertainty, which can significantly impact the City's reported results.

We are responsible for discussing with the Audit Committee our views about the significant qualitative aspects of the City's accounting practices, including the appropriateness of accounting policies, the reasonability of key accounting estimates and judgments, as well as the adequacy of financial statement disclosures.

Our comments and conclusions included in this report should only be taken in the context of the consolidated financial statements as a whole and are not meant to express an opinion on any individual item or accounting estimate.

During the audit, we dealt with the following complex issues, areas of judgment and significant audit risks:

Item 1	Employee benefits – TTC pension plan
<p><b>Background information and management's process</b></p>	<p>During the year, the City revisited the accounting for the TTC Pension Fund Society (the plan) on consolidation and concluded that the plan should be accounted for as a "Joint sponsored pension plan" under Public Sector Accounting Standards (PS), Section 3250, Retirement Benefits (Section 3250), on the basis that the TTC and related employee group equally share in the significant risks associated with the plan.</p> <p>The plan is a hybrid defined benefit / defined contribution pension plan that covers substantially all of the TTC employees and provides pensions to members, based on the length of service and average base year (pensionable) earnings.</p> <p>Historically, the TTC has recognized as an expense the required contributions for employee services rendered in the period (i.e. annual cash contributions). Unlike a defined benefit plan, no pension asset / liability has been recognized in the consolidated statement of financial position.</p> <p>As a joint sponsored pension plan, the City is required to account for its portion of the plan in accordance with the standards for defined benefit plans. As a result, the City is required to recognize its portion of the pension asset (subject to certain limits as defined in Section 3250) in the consolidated statement of financial position.</p> <p>To quantify the impact of this change, management engaged their actuary to calculate the pension asset at January 1, 2009, December 31, 2009 and December 31, 2010 and the pension expense for each of the 2009 and 2010 years. It was determined that the pension asset at January 1, 2009 is \$203.7 million and the pension expense for the 2009 year is \$115 million. The City had previously reported a pension expense of \$76 million in 2009 and had not recognized an asset at January 1, 2009.</p>

<b>Item 1</b>	<b>Employee benefits – TTC pension plan</b>
	<p>The amounts were viewed as significant to the consolidated financial statements of the City. Accordingly, this change has been accounted for on a retroactive basis, with prior period restatement, in accordance with PS Section 2120, Accounting Changes (Section 2120).</p> <p>The change in accounting for the plan resulted in an overstatement of employee benefit liabilities and understatement of accumulated surplus of \$203.7 million at January 1, 2009. In addition, the change resulted in an increase to pension expense (classified as Transportation expenses in the consolidated statement of operations) and a decrease to annual surplus of \$38.1 million for the 2009 year.</p> <p>The restatement has been disclosed in note 2 of the consolidated financial statements.</p>
<b>PwC's views</b>	<p>We reviewed the plan agreement and believe management's classification of the plan as a "Joint Sponsored Pension Plan" under Section 3250 is supportable. In addition, we concur that the change should be accounted for on a retroactive basis, with prior period restatement.</p> <p>As disclosed in our audit plan document that we presented to you at the February 2011 Audit Committee meeting, our audit approach includes the reliance on the work of certain specialists. In this instance, we relied on the actuary for their calculation of the pension asset and expense (income) for the applicable years.</p> <p>In accordance with generally accepted auditing standards, our audit procedures mainly consist of reviewing the reasonableness of the data and assumptions used by the actuary and do not include a re-performance of the actuarial calculations.</p> <p>Accordingly, we performed the following audit procedures when relying on the work of specialists:</p> <ul style="list-style-type: none"> <li>• Tested the participant data provided to the actuary by comparing the data to source documents maintained by the TTC's payroll department;</li> <li>• Tested that the significant actuarial assumptions (i.e .discount rates, rate of return on plan assets, etc.) are within a reasonable range and consistent with the provisions in the TTC's plan; and</li> <li>• Tested that the City is in compliance with the appropriate accounting principles for the calculation, presentation and disclosure of the pension balances within the consolidated financial statements of the City</li> </ul> <p>We have no exceptions to report as a result of completing these audit procedures.</p>

<b>Item 2</b>	<b>Employee Benefits – Other pension and non-pension benefit plans</b>
<b>Background information and management's process</b>	<p>Employee benefit liabilities represent a significant liability of the City.</p> <p>The City provides certain benefits, including post-retirement and post-employment benefits, to certain of its employees.</p> <p>The City has received actuarial reports at December 31, 2010 for the pension and non-pension benefit pension plans including benefits for sick leave gratuity, self insured workplace safety insurance board (WSIB), dental, medical, long-term disability, City sponsored pension plans and other pension plans for Toronto Police Services and certain of the City's agencies, boards and commissions (ABC's).</p> <p>The assets and liabilities associated with these employee benefit plans are calculated by the City's actuaries and involve the use of significant assumptions, including but not limited to, the discount rate, expected rate of return on plan assets (where applicable), salary growth, inflation and health care inflation for dental, drugs, medical, and long-term disability.</p> <p>During the year, the City changed their methodology with respect to the discount rate used to value its employee benefit liabilities. Previously, the discount rate was determined using the long-term borrowing rate of the City. In 2010, the City determined the discount rate for the Toronto Civic (Civic) and Toronto Firefighters (Fire) pension plan using the expected rate of return on long-term assets in order to align the methodology with the City's other defined benefit pension plans. This change in methodology was accounted for prospectively and resulted in reduction to employee benefit liabilities (with a corresponding increase to annual surplus) of \$40 million in the year, \$30.6 million relates to prior years and \$9.4 million related to 2010.</p>
<b>PwC's views</b>	<p>As discussed in item 1 above, our audit approach involves the reliance on the work of the City's actuaries and in accordance with generally accepted auditing standards we relied on the actuary for their calculation of the employee benefit assets/liabilities and expense /income for the year.</p> <p>We performed audit procedures, as outlined in item 1 above, on the City's employee benefit plans and have no exceptions to report as a result of completing these audit procedures.</p> <p>We believe the change in methodology for the discount rate used in the City's Civic and Fire pension plans should be accounted for as a change in accounting policy in accordance with PS Section 2120, requiring retroactive adjustment with restatement of the prior year comparatives. Therefore, we have taken \$30.6 million to our summary of unadjusted misstatements at December 31, 2010 (Appendix B) as an overstatement of surplus in the current year with a corresponding understatement to opening accumulated surplus representing the amount of the adjustment relating to prior years.</p>

Item 3	Significant estimates and areas of management judgment
<p><b>Background information and management's process</b></p>	<p>There are a number of complex and significant accounting estimates that require management judgment in preparing the City's consolidated accounts at December 31, 2010.</p> <p>Significant provisions and estimates include:</p> <ul style="list-style-type: none"> <li>a) Provision for property tax appeals;</li> <li>b) Amounts to be collected for water usage; and</li> <li>c) Amounts to be collected for parking tags and provincial offenses.</li> </ul> <p>Management has processes and controls in place for formulating these estimates as summarized below:</p> <ul style="list-style-type: none"> <li>a) The provision for property tax appeals is based on management's estimates of losses relating to successful appeals by taxpayers. The provision is based on historical arbitration experience with consideration given to the age and nature of unsettled appeals</li> <li>b) Water revenue is based on water production charged to users at water rates approved by Council. The receivable for water usage at year-end represents the revenue between the last billing date to December 31 and is based on consumption estimates produced by the City's water information system adjusted for seasonality factors</li> <li>c) The estimates of amounts to be received for parking tags and provincial offenses are based on historical collection experience for these fines</li> </ul>
<p><b>PwC's views</b></p>	<p>We held discussions with management responsible for establishing these estimates to understand the key assumptions and validate and benchmark these judgments against our own expectations as summarized below:</p> <ul style="list-style-type: none"> <li>a) For property taxes we corresponded directly with Municipal Property Assessment Corporation (MPAC) to obtain the assessment of properties used in determining property taxation revenue for the year.</li> </ul> <p>We also validated the information on the rate of successful appeals to test the reasonability of the estimates made by management at year-end. For each property class (other than commercial which is discussed separately below), we compared management's "at-risk" rate used to calculate the provision to the average adjustment rate over the past ten years and found them to be comparable.</p> <p>Consistent with the prior year, management's "at-risk" rate for commercial appeals was based on the highest adjustment rate experienced over the past ten years on the basis that a greater percentage of open appeals pertain to properties with higher original assessed values. We concluded that this is a reasonable assumption.</p>

<b>Item 3</b>	<b>Significant estimates and areas of management judgment</b>
	<p>b) For water usage related receivables, we analyzed production data and approved water rates by Council, including certain assumptions over water loss and unbillable water revenue, and developed an independent expectation of the amount receivable relating to water usage at year-end. We compared our expectations with the balance recorded by the City and noted that the amounts recorded at year-end are within our expected range.</p> <p>c) For amounts to be collected for parking and provincial offenses, we analyzed historical collection information and developed an independent expectation of the receivable balances at year-end. As a result of completing these procedures, we believe that the amounts to be collected for parking and provincial offenses are understated by \$15 million and have recorded this amount on our summary of unadjusted misstatements in Appendix B.</p>

<b>Item 4</b>	<b>Revenue recognition</b>
<b>Background information and management's process</b>	<p>The City has several significant revenue streams from the following sources:</p> <ul style="list-style-type: none"> <li>◦ Property taxation;</li> <li>◦ Government transfers;</li> <li>◦ User charges for utilities, licensing fees, transit fees and fees for various programs/activities; and</li> <li>◦ Charges for land development re-development.</li> </ul> <p>The City has established revenue recognition accounting policies in accordance with the accounting standards for Public Sector Accounting. Revenue recognition policies refer to those policies management has put in place to ensure revenue is recorded in the consolidated financial statements accurately and completely and in the correct accounting period.</p>
<b>PwC's views</b>	<p>Through our meetings with management, we gained an understanding of the processes and controls in place surrounding revenue recognition and tested certain internal controls, where appropriate, to support our audit approach. As part of these meetings, we also reviewed and assessed the appropriateness of the accounting policies adopted by the City for recognizing revenue and ensured accounting policies are in accordance with generally accepted accounting principles.</p> <p>We performed a variety of audit procedures comprising confirmation of amounts with 3<sup>rd</sup> parties for property taxation and certain user fee revenue streams. In addition, we performed substantive analytical procedures and other tests of detail for all significant revenue streams.</p> <p>Based on our audit work performed, we have no matters to report with respect to revenue recognition.</p>

<b>Item 5</b>	<b>Contingent liabilities (including provisions for property and liability claims)</b>
<b>Background information and management's process</b>	<p>The City has assessed the likelihood of a loss occurring and, where appropriate, a liability has been recorded in accordance with PS, Section 3300, Contingent Liabilities.</p> <p>For non-insurance related claims, the City assessed the likelihood of loss using the expertise of the City's internal Legal Services Department and external legal counsel, where applicable.</p> <p>For insurance related claims, the City engaged external actuarial specialists to assist with the assessment of these liabilities at year-end.</p>
<b>PwC's views</b>	<p>For non-insurance related claims, we obtained independent legal confirmation letters from external counsel relating to the status of the claim and have discussed significant claims with internal counsel and management. As noted in Section 1 of our report, we have four legal confirmations that are outstanding at the time of writing. Based on the audit procedures completed to date we have no matters to report.</p> <p>For insurance related claims, we relied on the work of the actuary for the calculation of the self-insurance claims liability. We tested the assumptions used by the actuary (i.e. claims growth, discount rates) and found them to be with a reasonable range. In addition, we tested the claims data provided to the actuary for accuracy and completeness and note d no exceptions.</p>

<b>Item 6</b>	<b>Landfill closure and post-closure costs for active and inactive landfill sites</b>
<b>Background information and management's process</b>	<p>The City has an obligation under the Ontario Environmental Protection Act for the closure and maintenance of landfill sites.</p> <p>The City is required to account for such closure and maintenance under the requirements of PS 3270, Solid Waste Landfill Closure and Post-Closure Liability.</p> <p>Management, through the use of internal specialists, determines the landfill liabilities by estimating the costs to be incurred during the closure and post-closure period and using assumptions for inflation and discount rates to calculate the liability at year end.</p>
<b>PwC's views</b>	<p>We tested the estimated closure and post closure costs for active and inactive sites, which included comparing management's estimated costs to actual historical experience over the past ten years and developed an independent expectation of the liability at year-end.</p> <p>There are significant estimates which require management judgment in calculating the liability at year-end. These include estimates of the future expenditures to be incurred for the continual maintenance of inactive landfill sites as well as inflation and discount rates.</p>

<b>Item 6</b>	<b>Landfill closure and post-closure costs for active and inactive landfill sites</b>
	<p>We tested the assumptions for inflation and discount rates as part of our audit procedures and found them to be within a range of reasonableness; however, we noted that the cost estimates used by management to determine the liability exceeded historical experience for closure and post closure costs incurred over the past ten years. As a result, we identified an overstatement of the closure and post-closure costs of \$12 million and have included this amount in our summary of adjusted misstatements in Appendix B. This amount has been adjusted by management and is reflected in the consolidated financial statements of the City at December 31, 2010.</p>

<b>Item 7</b>	<b>Financial statement close process</b>
<b>Background information and management's process</b>	<p>The City's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting standards as issued by the Public Sector Accounting Standards Board (PSAB). The consolidation of the City accounts involves the accumulation of information from the City's accounting system, including obtaining relevant supporting information from various departments within the City as well as the consolidation of the accounts of the City's ABC's that form a part of the consolidated entity.</p> <p>The City's ABC's have stand alone accounting systems that differ from the City and the accounts of the ABC's are reported based on generally accepted accounting principles applicable to their organizations, which for most ABC's is not consistent with the accounting principles applied by the City. Therefore, the City is required to record consolidation adjustments to conform the accounting policies of the ABC's to the City when preparing the consolidated financial statements. In addition, there are transactions and balances between the City and its ABC's that are required to be eliminated when preparing the consolidated accounts of the City. As a result, the consolidation of the City's accounts at year-end is a lengthy, complex and manual process.</p>
<b>PwC's views</b>	<p>Our audit procedures were designed to test that all entities are appropriately accounted for within the consolidated financial statements of the City which includes the testing of significant adjusting journal entries and comparing the consolidation information for the significant ABC's to their local accounting records. As a result of completing these procedures, we identified audit differences in the accounting for employee benefits at the TTC and TCHC due to differences in the accounting frameworks between the City and its ABC's. These differences resulted in an understatement of the employee benefit liability for TTC and TCHC of \$16 million and \$10.2 million, respectively, and were not adjusted by management. Accordingly, they have been reflected in our summary of unadjusted misstatements at year-end.</p> <p>Our audit procedures also include reviewing the audit results of the significant consolidated entities to identify any amounts greater than our posting threshold of \$4.6 million not adjusted in the standalone financial statements of the ABC's. These have also been identified on the summary of unadjusted misstatements for the City (Appendix B).</p>

<b>Item 7</b>	<b>Financial statement close process</b>
	In addition, as a result of completing our audit procedures, we have also raised certain internal control recommendations relating to the financial statement close process for management's considerations which have been included in our internal control letter provided in Appendix E of this report.

<b>Item 8</b>	<b>Province of Ontario loan</b>
<b>Background information and management's process</b>	<p>In 2004, the City restructured its loan with the Province of Ontario (the Province) and in 2005, one of two scheduled repayments was made. The second payment to the Province was withheld and it was intended to be settled through the transfer of a property from the City to the Province. The property was not transferred to the Province and payment has not been made on the outstanding debt since 2005.</p> <p>We understand from management that the City continues to negotiate forgiveness of the outstanding loan with the Province; however, to date no formal agreement has been reached.</p>
<b>PwC's views</b>	<p>The loan balance outstanding at December 31, 2010 is approximately \$170 million plus accrued interest of \$28 million. In the absence of formal forgiveness of the debt, the City continues to record both the principal and the accrued interest on the loan in order to reflect the current amount legally owing to the Province.</p> <p>As part of our audit procedures, we confirmed the loan balance with the Province and tested management's calculations of the accrued interest. As a result of our accrued interest testing, we identified an understatement of accrued interest of \$8 million and management adjusted this amount in the consolidated financial statements at December 31, 2010. Accordingly, this amount has been included in our summary of adjusted misstatements in Appendix B.</p>

<b>Item 9</b>	<b>Management override of controls</b>
<b>Background information and management's process</b>	<p>Canadian auditing standards require auditors to plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatements, whether caused by error or fraud.</p> <p>The likelihood of not detecting a material misstatement resulting from fraud is higher than the likelihood of not detecting a material misstatement resulting from error, because fraud may involve collusion as well as sophisticated and carefully organized schemes designed to conceal it.</p> <p>We note that the City has developed policies and procedures to ensure appropriate segregation of duties to mitigate the risk of fraud and management override of controls.</p>

<b>Item 9</b>	<b>Management override of controls</b>
	In addition, the City has policies in place to prevent and detect fraud, including maintaining a code of conduct, reviewing whistle blower hotline reports, internal audit and Auditor General Office (AGO) departments, processes relating to the review and approval of manual journal entries and management reviews of the divisional operating results of the City.
<b>PwC's views</b>	<p>During our audit, we executed the following procedures in order to fulfill our responsibilities:</p> <ul style="list-style-type: none"> <li>• inquired of management, audit general's office and others related to any knowledge of fraud or suspected fraud;</li> <li>• performed disaggregated analytical procedures, primarily over revenue, including consideration of unusual or unexpected relationships;</li> <li>• incorporated an element of unpredictability in the selection of the nature, timing and extent of our audit procedures;</li> <li>• performed additional required procedures to address the risk of management's override of controls, including: <ul style="list-style-type: none"> <li>◦ examined journal entries and other adjustments for evidence of the possibility of material misstatement due to fraud;</li> <li>◦ reviewed accounting estimates for biases that could result in material misstatement due to fraud, (including a retrospective review of significant prior years' estimates); and</li> <li>◦ evaluated the business rationale of significant unusual transactions.</li> </ul> </li> </ul> <p>As a result of completing these procedures we did not encounter any instances of fraud.</p>

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### ***3. Summary of unadjusted and adjusted misstatements***

Our responsibility is to issue an opinion as to whether the consolidated financial statements are free of material misstatement.

As a result of our audit, we identified certain items and have discussed these with management. The items that remain unadjusted are summarized in Appendix B. Under Canadian Auditing Standards we are required to ask the Audit Committee to consider adjusting the consolidated financial statements for these items.

We are also required to communicate the effects of any unadjusted misstatements that relate to prior periods. These are also included in Appendix B.

Management has adjusted the consolidated financial statements to reflect certain of these items. A summary of adjustments made as part of the audit process is also included in Appendix B.

We have concluded that the consolidated financial statements taken as a whole are free of material misstatement and (pending the completion to our satisfaction of the outstanding matters identified in section 1), we are prepared to issue an unqualified opinion on the consolidated financial statements.

## 4. Other required communications

Canadian Auditing Standards require that the external auditor communicate certain matters to the Audit Committee that may assist you in overseeing management's financial reporting and disclosure process.

Below, we summarize these required communications as they apply to the City:

<b>Matter to be communicated</b>	<b>PwC's response</b>
Management's representations	<ul style="list-style-type: none"> <li>• Under Canadian Auditing Standards, we are required to inform you of the representations we are requesting from management. A copy of the draft management representation letter is included in Appendix C.</li> </ul>
Significant deficiencies in internal control	<ul style="list-style-type: none"> <li>• Changes to Canadian Auditing Standards require us to communicate to the Audit Committee internal control deficiencies identified as part of our audit.</li> <li>• A significant deficiency is defined as an internal control deficiency that we consider merits the attention of the Audit Committee.</li> <li>• See Appendix E of this report for our internal control recommendations that we would like to bring to the Audit Committee's attention.</li> </ul>
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none"> <li>• No difficulties or disagreements with management occurred while performing our audit that requires the attention of the Audit Committee.</li> </ul>
Fraud and illegal acts	<ul style="list-style-type: none"> <li>• No fraud involving senior management, employees with a significant role in internal control, or that would cause a material misstatement of the consolidated financial statements, came to our attention as a result of our audit procedures.</li> </ul>
Inclusion of "Other matter" paragraph in audit opinion	<ul style="list-style-type: none"> <li>• See Appendix A for our draft auditor's report including the "Other matter" paragraph, which discloses the change in auditor's for 2010 and the prior year restatement as discussed above.</li> </ul>

## ***5. Internal control recommendations***

The purpose of our audit was to enable us to express an opinion on the consolidated financial statements.

We considered the City's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the consolidated financial statements but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting.

Accordingly, we have submitted for management comments those observations and recommendations designed to help the City improve its system of internal control and achieve operational efficiencies. See Appendix E for a copy of our management letter.

## ***6. 2010 audit fees***

Our fees are in accordance with our response to the City's Request for Proposal No. 9171-09-7137 dated December 1, 2009 covering the five year contract period for the years ended December 31, 2010 through to 2014. The fee for the 2010 audit of the City's consolidated financial statements is \$274,980.

We have also agreed an additional amount of \$19,500 with management for audit and accounting services with respect to the employee benefit restatement of the consolidated financial statements of the City.

## ***Appendix A: Draft auditor's report***

**Independent Auditor's Report****DRAFT**

To the Members of Council, Inhabitants and Ratepayers of the  
City of Toronto

We have audited the accompanying consolidated financial statements of the City of Toronto, which comprise the consolidated statement of financial position as at December 31, 2010 and the consolidated statements of operations and accumulated surplus, change in net debt, and cash flows for the year then ended, and the related notes including a summary of significant accounting policies and other explanatory information.

**Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the City of Toronto as at December 31, 2010 and the results of its operations, changes in its net debt and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

**Other matter**

Without modifying our opinion, we draw attention to Note 2 to the consolidated financial statements which explains that certain comparative information for the year ended and as at December 31, 2009 has been restated. The consolidated financial statements as at December 31, 2009 and for the year then ended, prior to restatement of the comparative information, were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements in their report dated June 2, 2010.

**Chartered Accountants, Licensed Public Accountants**

Toronto, Canada

[Date of the auditor's report]

## ***Appendix B: Summary of unadjusted and adjusted misstatements***

**a. Unadjusted misstatements**

<i>(all amounts in millions)</i>	<b>Statement of Operations</b>		<b>Statement of Financial Position</b>	
<b>Description</b>	<b>Surplus Over/(Under) Stated</b>	<b>Assets (Over)/Under Stated</b>	<b>Liabilities Over/(Under) Stated</b>	<b>Opening Accumulated Surplus Over/(Under) Stated</b>
<b><i>Current year unadjusted misstatements</i></b>				
1. Understatement of employee benefit expense in the current year as a result of a change in the methodology for developing discount rates which was accounted for prospectively but should have been accounted for retrospectively	30.6			(30.6)
2. Understatement of TTC employee benefit liability arising from differences in the accounting frameworks between the City and TTC			(16)	16
3. Understatement of TCHC employee benefit liability, current year surplus and an overstatement of opening surplus arising from differences in the accounting frameworks between the City and TCHC	(4.1)		(10.2)	14.3
4. Understatement of court services and parking tags amounts estimated to be collected	(15)	15		
5. Understatement of liabilities and tangible capital assets for construction contract expenditures not recorded at year end		14	(14)	
6. Overstatement of prior year depreciation corrected in the current year relating to the TTC. Current year operating surplus overstated	(10.1)			10.1
7. Elimination of inter-organizational amounts with the City and ABC's	6 (6)			
<b>Total unadjusted differences before impact of prior year differences</b>	<b>1.4</b>	<b>29</b>	<b>(40.2)</b>	<b>9.8</b>
<b><i>Prior year unadjusted misstatements</i></b>				
Prior year amounts noted by predecessor auditor which flow through current period operations	4.6	5.8		(10.4)
<b>Total Unadjusted Misstatements</b>	<b>6</b>	<b>34.8</b>	<b>(40.2)</b>	<b>(0.6)</b>

## b. Adjusted misstatements

As a result of our audit, we noted the following items that management has adjusted within the consolidated financial statements:

<i>(all amounts in millions)</i>	<b>Statement of Operations</b>		<b>Statement of Financial Position</b>	
<b>Description</b>	<b>Operating surplus Over/(Under) Stated</b>	<b>Assets (Over)/Under Stated</b>	<b>Liabilities Over/(Under) Stated</b>	<b>Operating surplus Over/(Under) Stated</b>
<b><i>Current year adjusted misstatements</i></b>				
1. Accounting for TTC Pension Fund Society under PS Section 3250	42	124		(166)
2. Overstatement of the liability for landfill closure and post-closure costs	(12)		12	
3. Understatement of accrued interest on a loan payable to the Province of Ontario	8		(8)	
4. Understatement of accounts receivable and accounts payable for funds received from the Province of Ontario which were originally recorded as a reduction to accounts payable		45	(45)	
5. Understatement of prepaid expenditures and overstatement of accounts receivable in respect of daycare services to be provided as amounts were originally included within accounts receivable		20 (20)		
6. Overstatement of surplus and understatement of assets to account for the loss on the sale of a property - Toronto Community Housing Corporation	9	(9)		
7. Understatement of deferred revenue and receivables to reclassify as amounts were originally included as a reduction to deferred revenue		13	(13)	
8. Reclassify amounts within revenue between user charges, funding transfers from other governments and other revenue.	486 (486)			
<b>Total Adjusted Differences</b>	<b>47</b>	<b>173</b>	<b>(54)</b>	<b>(166)</b>

***Appendix C: Draft management representation letter***

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[Date]

Ms. Cathy Russell, Partner  
PricewaterhouseCoopers LLP  
Royal Trust Tower  
TD Centre, Suite 3000  
Toronto, Ontario  
M5K 1G8

Dear Ms Russell:

We are providing this letter in connection with your audit of the consolidated financial statements of the City of Toronto (the City) as of December 31, 2010 and for the year then ended for the purpose of expressing an opinion as to whether such consolidated financial statements present fairly, in all material respects, the financial position, the results of operations and the cash flows of the City in accordance with Canadian public sector accounting standards.

**1. Management's responsibilities**

We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated November 1, 2010. In particular, we confirm to you that:

- We are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with Canadian public sector accounting standards;
- We are responsible for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error. In this regard, we are responsible for establishing policies and procedures that pertain to the maintenance of accounting systems and records, the authorization of receipts and disbursements, the safeguarding of assets and for reporting financial information in accordance with Canadian public sector accounting standards;
- We have provided you with all relevant information and access, as agreed in the terms of the audit engagement; and
- All transactions have been recorded in the accounting records and are reflected in the consolidated financial statements.

We confirm the following representations:

**2. Preparation of consolidated financial statements**

The consolidated financial statements include all disclosures necessary for fair presentation in accordance with Canadian public sector accounting standards and disclosures otherwise required to be included therein by the laws and regulations to which the City is subject.

We have appropriately reconciled our books and records (e.g. general ledger accounts) underlying the consolidated financial statements to their related supporting information (e.g. sub ledger or third party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the consolidated financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to an operations account and vice versa. All consolidating entries have been properly recorded. All inter-governmental unit accounts have been eliminated or appropriately measured and considered for disclosure in the consolidated financial statements.

**3. Accounting policies**

We confirm that we have reviewed the City's accounting policies and, having regard to the possible alternative policies, our selection and application of accounting policies and estimation techniques used for the preparation and presentation of the consolidated financial statements is appropriate in the City's particular circumstances to present fairly in all material respects its financial position, results of operations and cash flows in accordance with Canadian public sector accounting standards.

**4. Internal controls over financial reporting**

We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the City, including its consolidated subsidiaries, is made known to us by others within those entities.

We have designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian public sector accounting standards.

We have disclosed to you all deficiencies in the design or operation of disclosure controls and procedures and internal control over financial reporting that we are aware as of December 31, 2010.

**5. Disclosure of information**

We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the consolidated financial statements, such as records, documentation and other matters including:
  - Contracts and related data;
  - Information regarding significant transactions and arrangements that are outside of the normal course of business;
  - Minutes of the meetings of the Executive and Audit Committees . The most recent meetings held were: Executive Committee on May 24, 2011 and Audit Committee on May 12, 2011;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

**6. Completeness of transactions**

All contractual arrangements entered into by the City with third parties have been properly reflected in the accounting records or/and, where material (or potentially material) to the consolidated financial statements, have been disclosed to you. We have complied with all aspects of contractual agreements that could have a material effect on the consolidated financial statements in the event of non-compliance.

**7. Fraud**

We have disclosed to you:

- The results of our assessment of the risk that the consolidated financial statements may be materially misstated as a result of fraud;
- All information in relation to fraud or suspected fraud of which we are aware affecting the City involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the consolidated financial statements; and
- All information in relation to any allegations of fraud, or suspected fraud, affecting the City's consolidated financial statements, communicated by employees, former employees, regulators or others.

**8. Compliance with laws and regulations**

We have disclosed to you all aspects of laws, regulations and contractual agreements that may affect the consolidated financial statements, including actual or suspected non-compliance with laws and regulations whose effects should be considered when preparing consolidated financial statements.

We are not aware of any illegal or possibly illegal acts committed by the City's employees acting on the City's behalf.

**9. Accounting estimates and fair value measurements**

Significant assumptions used by the City in making accounting estimates, including fair value accounting estimates, are reasonable.

For recorded or disclosed amounts in the consolidated financial statements that incorporate fair value measurements, we confirm that:

- The measurement methods are appropriate and consistently applied;
- The significant assumptions used in determining fair value measurements represent our best estimates, are reasonable and have been consistently applied;
- No subsequent event requires adjustment to the accounting estimates and disclosures included in the consolidated financial statements; and
- The significant assumptions used in determining fair value measurements are consistent with the City's planned courses of action. We have no plans or intentions that have not been disclosed to you, which may materially affect the recorded or disclosed fair values of assets or liabilities.

Significant estimates and measurement uncertainties known to management that are required to be disclosed in accordance with The Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting Handbook Section PS 2130, Measurement Uncertainty have been appropriately disclosed.

**10. Related parties**

We confirm the completeness of information provided to you regarding the identification of related parties as defined by CAS 550 – Related Parties. We also confirm the completeness of information provided to you regarding the nature of the City's relationships with and transactions involving those entities.

The list of related parties attached to this letter as Appendix A accurately and completely describes the City's related parties and the relationships with such parties.

**11. Going concern**

We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the consolidated financial statements (e.g. to dispose of the entity or to cease operations).

**12. Assets and liabilities**

We have satisfactory title or control over all assets. There are no liens or encumbrances on the City's assets and no assets are pledged as collateral.

We have recorded or disclosed, as appropriate, all liabilities, in accordance with Canadian public sector accounting standards. All liabilities and contingencies, including those associated with guarantees, have been disclosed to you and are appropriately reflected in the consolidated financial statements.

**13. Litigation and claims**

All known actual or possible litigation and claims, which existed at the statement of financial position date or exist now, have been disclosed to you and accounted for and disclosed in accordance with Canadian public sector accounting standards, whether or not they have been discussed with legal counsel.

**14. Misstatements detected during the audit**

Certain representations in this letter are described as being limited to those matters that are material. Items are also considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm that the consolidated financial statements are free of material misstatements, including omissions.

The effects of the uncorrected misstatements in the consolidated financial statements, as summarized in Appendix B of your audit committee report, are immaterial, both individually and in the aggregate, to the consolidated financial statements taken as a whole. We confirm that we are not aware of any uncorrected misstatements other than those included in Appendix B.

The adjusted misstatements identified during your audit and summarized in Appendix C of your audit committee report have been approved by us and adjusted in the consolidated financial statements.

**15. Cash and banks**

The books and records properly reflect and record all transactions affecting cash funds, bank accounts and bank indebtedness of the City.

All cash balances are under the control of the City, free from assignment or other charges, and unrestricted as to use, except as disclosed to you.

The amount shown for cash on hand or in bank accounts excludes trust or other amounts which are not the property of the City.

All cash and bank accounts and all other properties and assets of the City of which we are aware are included in the consolidated financial statements at December 31, 2010.

**16. Restricted assets and revenues**

All assets and revenues subject to restrictions are disclosed in the consolidated financial statements.

All externally restricted inflows have been recognized as revenue in the period in which the resources were used for the purposes specified. All externally restricted inflows received before this criterion has been met have been reported as liabilities until the resources are used for the purposes specified.

**17. Accounts receivable**

All amounts receivable by the City were recorded in the books and records.

Amounts receivable is considered to be fully collectible. All receivables were free from hypothecation or assignment as security for advances to the City, except as hereunder stated.

Receivables recorded in the consolidated financial statements represent bona fide claims against debtors for sales or other charges arising on or before the statement of financial position date and are not subject to discount except for normal cash discounts. Receivables classified as current do not include any material amounts that are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.

**18. Loans receivable**

Loans receivable are not to be repaid through future appropriations, nor do they contain forgivable conditions and so have been accounted for as financial assets, in accordance with PS 3050, Loans Receivable.

We have reviewed loans receivable for collectability, risk of loss and expected forgiveness, and made appropriate valuation allowances or writeoffs thereon if necessary, in accordance with PS 3050, Loans Receivable.

**19. Inventory**

Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.

**20. Financial assets (other than loans and receivables)**

All securities which were owned by the City were recorded in the accounts.

All income earned on the financial assets has been recorded in the accounts, and any interest income has been accrued using the effective interest rate method.

We are not aware of any objective evidence of impairment that would result in the recognition of an impairment loss on any financial asset.

You have been informed of the acquisition of or the formation of all government units, business enterprises, partnerships, joint ventures or other participations during the period.

All transactions with governmental units, business enterprises, partnerships or joint ventures have been recorded in the accounts presented to you. All investments in and advances to governmental units, business enterprises, partnerships, joint ventures or other participations are appropriately recorded, and there is no evidence of impairment in value below the resulting balances shown in the consolidated financial statements.

There has been no activity in any dormant or inactive government units, business enterprises, partnerships, joint ventures or other participations, except as disclosed to you.

The modified equity method is used to account for the City's investment in the following government business enterprises; Enwave Energy Corporation ("Enwave"), Toronto Hydro Corporation and Toronto Parking Authority.

**21. Tangible capital assets**

All charges to tangible capital asset accounts represented the actual cost of additions to tangible capital assets.

All contributed tangible capital assets have been recorded at fair value at the date of the contribution.

No significant tangible capital asset additions were charged to repairs and maintenance or other expense accounts.

Book values of tangible capital assets sold, destroyed, abandoned or otherwise disposed of have been eliminated from the accounts.

Tangible capital assets owned by the City are being depreciated on a systematic basis over their estimated useful lives, and the provision for depreciation was calculated on a basis consistent with that of the previous date.

All lease agreements covering assets leased by or from the City have been disclosed to you and classified as leased tangible capital assets or operating leases.

Leased tangible capital assets are being amortized on a systematic basis over the period of expected use.

There have been no events, conditions or changes in circumstances that indicate that a tangible capital asset no longer contributes to the City's ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital asset is less than its net book value. We believe that the carrying amount of the City's long-lived tangible capital assets is fully recoverable in accordance with PS 3150.

**22. Long-term debt**

All borrowings and financial obligations of the City of which we are aware are included in the consolidated financial statements as at December 31, 2011, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

**23. Deferred revenue**

All material amounts of deferred revenue meet the definition of a liability and were appropriately recorded in the books and records.

**24. Retirement benefits, post-employment benefits, compensated absences and termination benefits**

All arrangements to provide retirement benefits, post-employment benefits, compensated absences and termination benefits have been identified to you and have been included in the actuarial valuation as required.

The details of all pension plan amendments since December 31, 2010, the date of the last actuarial valuation, have been identified to you.

The actuarial valuation dated December 31, 2010 incorporates management's best estimates, detailed as follows:

- a) The actuarial assumptions and methods used to measure liabilities and costs for financial accounting purposes for pension and other post-retirement benefits are appropriate in the circumstances.
- b) The City does not plan to make frequent amendments to the pension or other post-retirement benefit plans.

All changes to the plan and the employee group and the fund's performance since the last actuarial valuation have been reviewed and considered in determining the pension plan expense and the estimated actuarial present value of accrued pension benefits and value of pension fund assets where latest actuarial valuation for accounting purposes is not at the balance sheet date.

The City's actuaries have been provided with all information required to complete their valuation as at December 31, 2010 and where applicable, their extrapolation to December 31, 2010.

We confirm that the extrapolations are accurate and include the proper reflection of the effects of changes and events occurring subsequent to the most recent valuation that had a material effect on the extrapolation.

The employee future benefit costs, assets and obligations have been determined, accounted for and disclosed in accordance with PS 3250 – Retirement Benefits and PS 3255 – Post-employment Benefits, Compensated Absences and Termination Benefits. In particular:

- a) The significant accounting policies that the City has adopted in applying PS 3250 and PS 3255 are accurately and completely disclosed in the notes to the consolidated financial statements.
- b) Each of the best estimate assumptions used reflects management's judgment of the most likely outcomes of future events.

- c) The best estimate assumptions used are, as a whole, internally consistent, and consistent with the asset valuation method adopted.
- d) The discount rate used to determine the accrued benefit obligation was determined by reference to the City's borrowing rate or the plan asset earnings rates as deemed appropriate, at the measurement date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments; or inherent in the amount at which the accrued benefit obligation could be settled.
- e) The assumptions included in the actuarial valuation are those that management instructed Mercer, Buck and Aon to use in computing amounts to be used by management in determining pension costs and obligations and in making required disclosures in the above-named consolidated financial statements, in accordance with PS 3250.
- f) In arriving at these assumptions, management has obtained the advice of consulting actuaries who assisted in reaching best estimates, but has retained the final responsibility for them.
- g) The source data and plan provisions provided to the actuary for preparation of the actuarial valuation are accurate and complete.
- h) The disclosure of the City's share of the risks and benefits under joint defined benefit plans, the total financial status of any joint plans, significant policies and a description of the unique nature and terms of any joint plans are accurate and complete.
- i) All changes to plan provisions or events occurring subsequent to the date of the actuarial valuation and up to the date of this letter have been considered in the determination of pension costs and obligations and as such have been communicated to you as well as to the actuary.

**25. Statements of operations and net debt**

All transactions entered into by the City have been recorded in the books and records presented to you.

All amounts have been appropriately classified within the statements of operations and net debt.

The accounting principles and policies followed throughout the period were consistent with prior period practices (except as disclosed in the consolidated financial statements).

**26. Environmental matters**

There are no liabilities or contingencies arising from environmental matters that have not already been disclosed to the auditor.

Liabilities or contingencies related to environmental matters have been recognized, measured and disclosed, as appropriate, in the consolidated financial statements.

We have considered the effect of environmental matters and the carrying value of the relevant assets is recognized, measured and disclosed, as appropriate, in the consolidated financial statements.

All commitments related to environmental matters have been measured and disclosed, as appropriate in the consolidated financial statements.

**27. Use of a specialist**

We assume responsibility for the findings of other specialists in evaluating the employee benefit obligation and landfill closure and post-closure liabilities and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the consolidated financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.

**28. Minutes**

All matters requiring disclosure to or approval of the Executive Committee has been brought before them at appropriate meetings and are reflected in the minutes.

**29. General**

There are no proposals, arrangements or actions completed, in process, or contemplated which would result in the suspension or termination of any material part of the City's operations.

Information relative to any matters handled on behalf of the City by any legal counsel, including all correspondence and other files, has been made available to you.

**30. Segment disclosures**

Pursuant to PS 2700, Segment Disclosures, in identifying segments, management has considered the definition of a segment and other factors, including:

- a) the objectives of disclosing financial information by segment;
- b) the expectations of members of the community and their elected or appointed representatives regarding the key activities and accountabilities of the government;
- c) the qualitative characteristics of financial reporting as set out in PS 1000, Financial Statement Concepts;
- d) the homogeneous nature of the activities, service delivery, or recipients of the services;
- e) whether the activities relate to the achievement of common outcomes or services as reflected in government performance reports and plans;
- f) whether discrete financial information is reported or available; and
- g) the nature of the relationship between the government and its organizations (within the reporting entity).

Management has identified following operating segments: General government, Protection to persons and property, Transportation, Environmental services, Health services, Social and family services, Social housing, Recreational and cultural services and Planning and development

The consolidated financial statements disclose all the relevant factors used to identify the City's reportable segments.

Changes in accounting policies related specifically to segment reporting that have a material effect on segment information have been disclosed. Prior period segment information presented for comparative purposes has been restated.

**31. Government transfers**

Transfers without eligibility criteria or stipulations have been recognized as revenue once the transfer has been authorized.

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Transfers with eligibility criteria but without stipulations have been recognized as revenue once the transfer has been authorized and all eligibility criteria have been met.

Transfers with or without eligibility criteria but with stipulations have been recognized as revenue in the period the transfer has been authorized and all eligibility criteria have been met, except when, and to the extent that, the transfer gives rise to an obligation that meets the definition of a liability for the recipient government in accordance with PS 3200, Liabilities.

*Disclosure*

The major kinds of transfers recognized have all been disclosed in the consolidated financial statements as well as the nature and terms of liabilities arising from government transfers received.

**32. Budgetary data**

We have included budgetary data in our consolidated financial statements which is relevant to the users of the consolidated financial statements. Planned results were presented for the same scope of activities and on a basis consistent with that used for actual results.

**33. Events after balance sheet date**

We have identified all events that occurred between the statement of financial position date and the date of this letter that may require adjustment of, or disclosure in, the financial statements, and have effected such adjustment or disclosure.

Yours truly,

**The City of Toronto**

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Mr. J. Pennachetti, City Manager

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Mr. C. Weldon, Deputy City Manager & Chief Financial Officer

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Ms. G. Carbone, Treasurer

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Mr. M. St. Amant , Director Accounting Services

## ***Appendix D: Independence letter***

June 20, 2011

Members of the Audit Committee, Sub Committee of City Council  
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 ended December 31, 2010.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the City, its management and us that may reasonably be thought to bear on our independence.

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

- (a) holding a financial interest, either directly or indirectly, in a client;
- (b) serving as an officer or director of a client;
- (c) performance of management functions for an assurance client;
- (d) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client or its management;
- (e) economic dependence on a client;
- (f) long association of senior personnel with a listed entity audit client;
- (g) audit committee approval of services to a listed entity audit client; and
- (h) provision of services in addition to the audit engagement.

We are not aware of any relationships between the City or its management and PricewaterhouseCoopers LLP that may reasonably be thought to bear on our independence, that have occurred from December 1, 2009 (the date of our response to the City's Request for Proposal No. 9171-09-7137) to June 20, 2011.

We hereby confirm that we are independent with respect to the City within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of June 20, 2011.

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.

We look forward to discussing with you the matters addressed in this letter at our upcoming meeting on July 5<sup>th</sup>, 2011.

Yours very truly,

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants

## ***Appendix E: Internal control recommendations***

June 20, 2011

Mr. Cam Weldon  
Deputy City Manager and Chief Financial Officer  
City of Toronto  
Metro Hall – 55 John Street  
Toronto, Ontario  
M5V 3C6

Dear Mr. Weldon:

**Management Letter**  
**2010 Audit of City of Toronto**

We have substantially completed our audit examination of the City of Toronto. Our audit was directed at providing the basis for our opinion on the consolidated financial statements for the year ended December 31, 2010. During the course of our work, we noted several areas where we believe that controls and procedures could be improved and accordingly, we enclose a memorandum of recommendations designed to address these matters. We summarize these observations and recommendations in the appendix attached to this letter.

Our examination was designed in accordance with Canadian generally accepted auditing standards to enable us to express an opinion on the consolidated financial statements as a whole and our work involved evaluating only those systems and internal controls in your organization upon which we intend to rely. The objective of an audit is to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. Therefore, this memorandum does not necessarily include all matters that may be of interest to management, which a more extensive or special internal controls examination might develop. It is not designed to identify and cannot necessarily be expected to uncover fraud, defalcations and other irregularities.

The responsibility for the maintenance of an adequate system of internal control, as well as for the prevention and detection of irregularities rests with management and we trust you will find the recommendations in this letter helpful in achieving this objective.

This communication is prepared solely for the information of management and is not intended for any other purpose. We accept no responsibility to a third party who uses this communication.

We would like to take this opportunity to thank the management and staff of the City of Toronto for the co-operation that we received during the course of our audit. Please do not hesitate to contact us if there are any matters in this letter that you would like to discuss further.

*PricewaterhouseCoopers LLP*

Cathy Russell  
Partner  
Audit and Assurance Group

Encl.

<b>Table of Contents</b>	<b>Page</b>
<b>1. City of Toronto (manual internal control related recommendations) .....</b>	<b>1</b>
1.1. Financial statement close process.....	1
1.2. Timesheet approval process .....	2
1.3. Communication of employee terminations .....	3
1.4. Bank Account signatory list.....	4
1.5. Reconciliation of investment balances.....	4
1.6. Employee future benefits experience study.....	5
1.7. Consistency of actuarial assumptions.....	5
1.8. Recognition of liabilities for construction contracts .....	6
<b>2. City of Toronto (Information Technology internal control related recommendations) .....</b>	<b>7</b>
2.1. Database and Operating Systems Password Controls.....	7
2.2. Dormant User Accounts .....	7
2.3. SAP Application Payroll Controls – Automated Configuration Controls and Segregation of Duties .....	8
2.4. Periodic User Access Rights Review .....	9
2.5. User Administration – Active Terminated Users.....	9
2.6. DDIC not Locked in SAP EDD .....	10
2.7. Access to Sensitive Basis Transactions in SAP ECC.....	10
2.8. Application Super-user Monitoring .....	11
2.9. Background Job Under Any User in SAP ECC .....	12
2.10. SAP Application Controls in Procurement Process – Automated Configuration Controls .....	12
<b>3. Toronto Police Services (TPS) .....</b>	<b>13</b>
3.1. Payroll – Timesheet approval process .....	13
3.2. Information Technology – Dormant User Accounts.....	13
3.3. Information Technology – Periodic User Access Rights Review.....	14
3.4. Information Technology – SAP Application Controls in Procurement Process – Sensitive Analysis / Segregation of Duties .....	14

## 1 City of Toronto (manual internal control related recommendations)

### 1.1 Financial statement close process

#### **Observation:**

The financial statement close process (FSCP) includes the initiation, authorization and recording of journal entries and preparing the financial statements. The FSCP also includes financial statement disclosures where transactions, events, or conditions required to be disclosed are accumulated, recorded, processed, summarized and appropriately reported in the consolidated financial statements.

The City's FSCP is a complex annual process given the number of Agencies, Boards and Commissions (ABC's) that are consolidated within its financial statement. In addition, with the exception of the Toronto Public Library Board, the ABC's follow different accounting standards than the City and their financial results need to be adjusted to conform to the City's accounting standards. Further, since the ABC's accounting systems are different than the City's, the consolidation is a manual process that is performed in Excel spreadsheets and as a result, is a complex and time consuming process to complete.

During the performance of our audit procedures relating to the City's financial statement close process, we noted a significant number of adjustments recorded on consolidation relating to intercompany eliminations, reclassifications, adjustments to the accounting records of the City's ABC's to conform with PSAB, and late adjustments identified by management .

#### **Impact:**

As the consolidation process is complex and manually driven, there is an increased risk of error with respect to consolidating the City's ABC's and recording consolidation adjustments.

#### **Recommendation:**

Management should consider enforcing the following policies and procedures to strengthen the FSCP process;

- Timely reporting of audited financial statements from ABC's sufficiently in advance of the City's reporting deadlines, including the implementation of an accountability framework and enforcement by the City for all ABC's;
- Timely communication by the ABC's to City management of any changes to their submitted financial statements;
- City management provide the ABC's with a reconciliation schedule of the ABC's accounting standards to the City's accounting under PSAB; and
- Appropriate level of review of ABC financial statements for significant disclosures that are required to be presented in the consolidated statements of the City.

In addition to the above recommendations, we would also suggest that the City consider using financial reporting software for consolidating the City and its ABC's.

#### **Management Response:**

Currently the year-end process has deadlines in place for reporting by ABC's though certain organizations have had difficulties providing the information as scheduled. For the 2011 year end process, staff will provide assistance and guidance to those ABC's converting to PSAB, delay the start of the auditors an additional week, and include escalation procedures, including offers of assistance to complete their financial information. In addition, the Director, Accounting Services will undertake a review of available software, determine benefits available, and consider whether purchasing consolidation software or enhancements to existing procedures will improve the year end process.

## 1.2 **Timesheet approval process**

### **Observation:**

During our testing of controls within the payroll cycle we noted instances where timesheets did not have evidence of review by appropriate supervisors. Certain timesheets of the following divisions were noted as not having evidence of review: Fire, 311, Parks & Recreational, Long-Term Care, and Toronto Water.

### **Impact:**

Employees may be paid based on hourly information that is either invalid or inaccurate.

### **Recommendation:**

Management should consider implementing an approval process requiring that all timesheets have evidence of appropriate approval at the division level prior to payroll processing.

### **Management Response:**

Time and Attendance is the responsibility of City Divisions and is subject to established rules and guidelines which require that all exception reporting be reviewed and authorized by an employee's Supervisor/Manager. In order to ensure the validity and accuracy of payments to employees, the City of Toronto has existing approval processes in place with respect to exception reporting. These processes vary depending on whether the Division is one that has an interface or not. The approval processes are as follows:

For Divisions that have a divisional custom-designed time and attendance interface with information uploaded to the payroll system of SAP (e.g. Fire, Long-Term Care and Parks & Recreation)

These Divisions rely on an electronic approval process in the custom-built time and attendance system of the division. Individual Manager, Supervisor or District Chief (for Fire) at various off-site locations is required to electronically approve the time-sheet. Since the login to the time and attendance system is restricted to each user and protected by the system's security, it should serve as each user's electronic signature.

For Divisions that do not have an interface

The approval process is either done on the hard copy of the absence request form submitted by the employee or via email by the corresponding Supervisor/Manager. Email approvals are appropriate when the employee is situated in a different location from the Manager and there is a lack of administrative support to the approving Manager.

In addition, the Pension, Payroll & Employee Benefits Division ensures the accuracy of payroll/payments through a review of exception and variance reports and setting up various controls in the payroll system. Routinely, all payroll staff work diligently to follow-up with Divisions to confirm/clarify any anomaly and to avoid any possible overpayment. As part of our oversight role, we routinely provide training and guidelines in addition to annual memos to Division Heads and distribution of a Key Controls Checklist. This information is also available on our intranet site, which is currently being updated.

The Pension, Payroll & Employee Benefits Division agrees to enhance its oversight by beginning a new audit process to monitor the reporting of time and attendance by Divisions through random checking of divisional timesheets and SAP entries. This process will begin in 3<sup>rd</sup> quarter, 2012.

### **1.3 Communication of employee terminations**

#### **Observation:**

In our testing of employee terminations, we noted instances where there was a time lapse between the date of termination and the date the Payroll department was notified of the termination. Currently, the Payroll department receives updates with respect to employee terminations from Human Resources department, who obtains this information from the respective divisions.

#### **Impact:**

In the event there is a significant delay in the communication between the City's departments as it relates to employee terminations there is a risk that individuals may incorrectly continue to receive compensation from the City for services no longer performed.

#### **Recommendation:**

Management should consider implementing policies that require formal reporting between the divisions; Human Resources and Payroll departments as part of each payroll run ensuring that all employee changes are provided to Payroll in a timely manner.

#### **Management Response:**

The Pension, Payroll & Employee Benefits Division recently forwarded to all Divisions a Key Controls Guideline Document in addition to a memo which stipulates the responsibilities of Payroll, Human Resources and Divisions.

In addition, the City has prepared a completion guide which provides a documented process for Divisions and Human Resources to utilize when completing an employee separation notice (ESN). In some instances, there is a delay in submitting these notices to payroll as a result of the Division not yet having details regarding the nature of the termination or the exact termination effective date. In these situations, in order to avoid any potential overpayment, PPEB will request an email from the Division (as temporary instruction) so that we payroll can change the employee to positive reporting, to avoid any overpayments.

The Pension, Payroll & Employee Benefits Division agrees to enhance its oversight by updating the Completion Guide to reinforce the importance of receiving timely information. This will be completed by 3<sup>rd</sup> quarter, 2012.

#### **1.4 Bank Account signatory list**

##### **Observation:**

In completing our testing of the City's cash balances at year-end we noted that the authorization signatories on file at certain bank branches are not up to date and included individuals who no longer work for the City.

##### **Impact:**

This increases the risk of misappropriation of City funds as unauthorized individuals may have access to City banking information.

##### **Recommendation:**

Management should consider retaining an authorization signature list for all its bank accounts. This list should be reviewed periodically to ensure that it is up to date with any changes to the list communicated to the appropriate financial institution in a timely manner.

##### **Management Response:**

Accounting Services staff updated the signing authorities for all accounts during the year-end audit. These documents will be reviewed annually and updated as signatories change.

#### **1.5 Reconciliation of Investment balances**

##### **Observation:**

In our testing of investment balances at year-end we noted differences in the cost of certain investments between the City and the trustee that were not reconciled at year-end. The City believes that these differences are a result of differing methodologies applied by the City and the trustee in calculating the amortized premium/discount on bonds when valuing the City's investment holdings at year-end.

##### **Impact:**

Differences that are not reconciled increase the risk of misappropriation of assets and assets held by the City are not being appropriately valued.

##### **Recommendation:**

Management should consider reconciling the City's internal treasury reports to the reports received by the trustee on an individual investment basis for any anomalies with consideration given to the different methodologies between the City and the trustee.

##### **Management Response:**

On a monthly basis, the City will reconcile internal treasury reports to the reports received by the trustee on an individual investment basis for any anomalies, with consideration given to the different methodologies between the City and the trustee.

## **1.6 Employee future benefits experience study**

### **Observation:**

During our testing of the City's employee benefits at year-end we noted that the City has never conducted an "experience study". Experience studies for sufficiently large organizations are typically conducted periodically to support the assumptions used by the actuaries in measuring the expense and liability for its defined benefit plans. In absence of an experience study, the City has relied on information from other third parties (such as OMERS) to develop the assumptions used to calculate the City's employee benefits amounts at year-end.

### **Impact:**

Assumptions used to determine the expense and liability for the City's defined benefit plans may not be accurate which can result in a misstatement in the expense and liability associated with the City's defined benefit plans.

### **Recommendation:**

We have audited management's assumptions at year-end and find them to be reasonable and supportable. However, we believe that the City is of significant size that an experience study prior to the next employee future benefits valuation would provide meaningful insights and further support management's estimates of assumptions.

### **Management Response:**

PPEB and Accounting Services have worked very closely with Buck Consultants to review the assumptions and approve each of the assumptions prior to the evaluation. It is the City's view that the assumptions used are reasonable and in accordance with the industry standards for public sector employers.

Notwithstanding the reasonableness of the assumptions, it has also been recommended by Buck Consultants that the City consider an experience study to further support all actuarial assumptions contained in their report.

The City will be issuing an RFP in the fall of 2012 for a Benefits Consultant to conduct a full Actuarial Valuation. At that time, we will also consider the inclusion of a requirement to conduct an experience study to support the actuarial assumptions.

## **1.7 Consistency of actuarial assumptions**

### **Observation:**

In our review of the actuarial assumptions used to calculate the expense and liability associated with the City's defined benefit pension plans we noted that certain actuarial assumptions are not consistent across all defined benefit plans such as the assumptions for inflation, mortality and salary growth.

### **Impact:**

Although the assumptions used do not appear to be unreasonable at December 31, 2010, certain of these assumptions, such as the City's view on inflation rates, should be internally consistent between the City's defined benefit plans. Significant deviations of assumptions within the City's defined pension plans can result in a misstatement in the City's defined benefit expense and liability for the period.

**Recommendation:**

In connection with the annual review of actuarial assumptions, management should consider coordinating with their actuaries to ensure that, where applicable, consistent assumptions are used across the City's defined benefit plans.

**Management Response:**

The City of Toronto sponsors 5 Pre-OMERS Pension Plans. The Pension Plans are administered through separate Boards of Trustees, who have oversight responsibility for the Plans and meet all of the fiduciary responsibilities under the Pension Benefits Act (PBA). Each of the Pension Boards retains their own actuary to prepare annual actuarial valuation reports. The actuary responsible for the plan brings forward their recommendations with respect to actuarial assumptions. In bringing actuarial assumptions forward, the actuary considers the asset mix and plan demographics in addition to industry standards and their recommendation. It is up to the Board of Trustees and not the City, to approve the actuarial assumptions.

Given that the Plans have different Actuaries and different Boards it is not unusual for each plan to approve different assumptions. This is outside of the City's control, and since the plans have very few active employees, the minor differences in the assumptions have little impact on the liability values.

**1.8 Recognition of liabilities for construction contracts**

**Observation:**

In completing our testing on accounts payable and accrued liabilities, we noted instances where services rendered during 2010 in respect of construction contracts were not recorded at December 31, 2010. The cut off errors noted in our audit sample totalled \$14 million at December 31, 2010 resulting in an understatement of liabilities with a corresponding understatement of tangible capital assets.

**Impact:**

There is a risk that significant liabilities may be unrecorded at year end and therefore not included within the financial records of the City in the correct period.

**Recommended Practice:**

The City should review their current internal processes related to the recording of capital expenditures and ensure a more diligent year end review of costs incurred in the period so that appropriate accruals can be made.

**Management Comment:**

Although City staff has been diligent in recording operating expenses properly at year end to ensure they are properly compared with budget, the same diligence has not been used for capital items as capital budgets are life-to-date. Future Accounting Services year-end cut-off procedures will reinforce the need to ensure that capital items are recorded in the proper year.

## **2 City of Toronto (Information technology internal control related recommendations)**

### **2.1 Database and Operating Systems Password Controls**

#### **Observation:**

PwC noted that the Account Lockout Duration of 15 minutes at the Database and Operating System levels of SAP production environment (enforced through Novell) is not set to the standard industry practice of 0 minutes (which results in the account being locked out until an administrator explicitly unlocks it).

#### **Impact:**

An unauthorized user could attempt to access the system without being locked out.

#### **Recommendation:**

Management should consider setting up the 'Account Lockout Duration' to "0" to conform to the standard industry practice in this area.

#### **Management Response:**

##### ***SAP Competency Centre Information & Technology Division***

We have considered the latest functionality available in password complexity settings within SAP. The current SAP password complexity settings are aligned with the City's Information & Technology (I&T) policy for password complexity. Changes in the SAP password complexity require a change in City's I&T policy for password complexity. We will consider these changes in coordination with a review of the I&T Governance model.

### **2.2 Dormant User Accounts**

#### **Observation:**

In the SAP Basis security testing, PwC noted user accounts in the Finance, payroll and HR divisions that have never logged into the production environment. Client 200, or have not logged into the system within the last three months.

#### **Impact:**

New user accounts which lay dormant with standard initial password accounts may lead to unauthorized access to the system. In addition, dormant user accounts may be creating unnecessary SAP licenses (and costs).

#### **Recommendation:**

Management should consider monitoring the dormant user accounts on a periodic basis, including dormant substitute user accounts, and deleting these accounts where appropriate

**Management Response:**

***Finance***

Lists are generated by the SAP CC for user accounts that have been dormant for 3 months and these user accounts are contacted to determine if access is still required.

***Payroll***

User accounts will be monitored to ensure dormant user accounts are removed on a regular basis.

***Human Resources***

Management will review these accounts and delete those accounts that should be deleted and inform the others to log in and change their password. In addition a periodic review will be performed to monitor this situation.

**2.3 SAP Application Payroll Controls - Automated Configuration Controls and Segregation of Duties.**

**Observation:**

During testing of the automated configuration controls related to payroll processing, we noted that approval by an independent person is not enforced by the SAP system for changes to payroll and HR master data. In addition, during our review of segregation of duties and access to sensitive authorization related to payroll processing, we noted that 95 user accounts have access to maintain their own core employee data and their own payment related data.

**Impact:**

The current configuration can result in individuals making unauthorized and undetected changes to the payroll and HR master data. Through our discussions with management we understand that the following compensating controls are in place to mitigate this risk:

- Changes to master data are reviewed and approved by an independent person (Buddy System) outside of the SAP system.
- A system generated report of user accounts that changed their own core employee data and their own payment related data (detailed and summary level) is reviewed on a periodic basis.

In addition, individuals may perform unauthorized changes to their own core employee and payment related data.

**Recommendation:**

Management should consider strengthening their existing manual controls by implementing a system enforced approval process (workflow) for changes to the master data and segregation access to user accounts to maintain their own core employee data and payment related data.

**Management Response:**

***Payroll***

The existing "Buddy System" accomplishes the same results as workflow; in addition the manual process ensures that information on the original documentation matches the information entered in the system. Workflow does not eliminated manual checking. As part of the approval process approvers would still be required to compare the source documentation to the information entered into the system. The City may consider the benefits of implementing workflow within the payroll module as part of a future capital project.

In Q2 2011 controls within the SAP security roles will be put in place to prevent user accounts from updating their own records through data entry. System generated reports will not be required once security controls are put in place.

#### **2.4 Periodic User Access Rights Review**

##### **Observation:**

PwC noted that SAP user divisions have daily processes in place for granting and removing access; however, there is no periodic review of access rights compared to user job responsibilities in SAP.

##### **Impact:**

Access that is not in accordance with job responsibilities may result in unauthorized activities and conflicts in segregation of duties.

##### **Recommendation:**

Management should consider requiring the SAP user department managers from all divisions to perform a review of the access rights for each user on a periodic basis, at least annually, which includes a confirmation of the employment status based on each employee's user ID and comparison of the level of access with their current job responsibilities.

##### **Management Response:**

###### ***Finance***

The City will annually send Divisions a list of users along with the associated SAP job roles for each user, requesting confirmation as to the continued need for access and the level of access for each employee.

###### ***Payroll***

An informal review was performed on user access rights within Payroll required by the business units in 2009. Management will consider establishing a formal procedure

###### ***Human Resources***

We agree. Management will work towards developing a formal process to review user accounts periodically.

###### ***Facilities***

FMD will be developing a custom report in 2011 to review staff job changes which will enable our management team to perform periodic reviews to PM (FMD/RES) and RE access.

###### ***Parks Forestry & Recreation***

PRF, Policy and Strategic Planning, Information Systems Unit, will be reviewing the current business practices for the SAP PM system and will be implementing system security and monitoring procedures for End-User access rights to the SAP PM application.

#### **2.5 User Administration – Active Terminated Users**

##### **Observation:**

Based on the results of our sample testing relating to the removal of application access rights of terminated users, including the substitute/supplementary accounts, PwC noted 2 active user accounts of terminated employees in SAP.

**Impact:**

Continuing access to terminated employees increases the risk that the ID of the terminated user is misused for unauthorized access to the system. If the City's user administration process is not followed, the risk of unauthorized and inappropriate access to the system increases.

**Recommendation:**

Management should consider re-enforcing the policies and procedures for deleting access rights of terminated employees to the City's IT infrastructure and applications ensuring timely removal of access rights for terminated employees. The removal of all access rights should be confirmed by administrators as part of employee exit procedures.

**Management Response:**

***SAP Competency Centre Information & Technology Division***

We agree with this observation. While an automated process for managing terminated users is in place, certain supplementary employee accounts (accounts that end with 76, 77, 88 & 99) were not subject to this automated removal process resulting in the delays noted. The ERP Competency Centre has implemented the necessary programming changes to ensure these supplementary accounts are also removed as part of the automated process in Q1 2011.

**2.6 DDIC not Locked in SAP ECC**

**Observation:**

We noted that SAP Standard User ID "DDIC" is not locked in SAP ECC production environment, client 200. User DDIC is a standard SAP user ID with special privileges in installation, software logistics, and the ABAP Dictionary.

**Impact:**

Unlocked DDIC increases the risk of unauthorized or inappropriate changes within the production environment, and may negatively impact system functionalities.

**Recommendation:**

Management should consider locking standard SAP user ID "DDIC" in production client 200. Only unlock as necessary.

**Management Response:**

***SAP Competency Centre Information & Technology Division***

We agree with this recommendation and it will be implemented in 2011 by the ERP CC Security team.

**2.7 Access to Sensitive Basis Transactions in SAP ECC**

**Observation:**

PwC noted that several user accounts having the ability to perform Sensitive Basis transactions within the production environment are not restricted.

PwC further noted several user accounts in the Finance, payroll and HR divisions have the ability to perform Sensitive Basis transactions within the production environment that are not required within their job responsibilities.

**Impact:**

Access to the Sensitive Basis transactions increases the risk of unauthorized or inappropriate changes within the production environment, and may negatively impact system functionality.

**Recommendation:**

Management should consider removing the Sensitive Basis transaction access rights from these user accounts immediately.

**Management Response:**

***SAP Competency Centre Information & Technology Division***

Certain of these Sensitive Basis transactions are a necessary function in the production system (such as the creation and change profile functions) due to an issue that can occur in the SAP Correction and Transport system. The ERP CC staffs are sometimes required to correct the problem directly in the production system because the transport was not successful. This approach is standard in the industry. We agree however that the procedures in this area we currently follow can be improved. The ERP CC will develop a new procedure similar to the existing "Emergency" production procedures in 2011.

***Finance, Payroll, Human Resources***

We agree with this observation. We will review these user accounts and access privileges and where appropriate will remove access.

**2.8 Application Super-user Monitoring**

**Observation:**

PwC noted that Super-user/administrative application transactions and activities are not monitored on a periodic basis for various divisions.

**Impact:**

Unauthorized changes can be made in the production environment by the privileged users that may be difficult to detect.

**Recommendation:**

Management should consider reviewing the super-user / administrative application transactions and activities on a periodic basis.

**Management Response:**

***Finance***

We will assess the costs and benefits of establishing a formal procedure in 2011.

***Human Resources***

Management will ensure that documentation relating to requests for mass data changes; the request for higher level access to perform these changes and notifications stating the changes have been completed will be kept together and stored in a manner so they can be later retrieved for review.

***Parks, Forestry & Recreation***

We agree with your observation. The PFR Policy and Strategic Planning, Information Systems Unit, will be reviewing the current business practices for the SAP PM system and will be implementing system security and monitoring procedures for Super user/administrative application transaction and activities of the SAP PM system.

## **2.9 Background Job Under Any User in SAP ECC**

### **Observation:**

PwC noted 3 Parks Forestry & Recreation (PFR) user accounts which have the ability to run a batch job under any user (via Administration) in SAP ECC which is not in accordance with their current job responsibilities.

### **Impact:**

Access to the running background jobs under any user (via Administration) transactions increases the risk of unauthorized or inappropriate changes within the production environment, and may negatively impact system functionalities.

### **Recommendation:**

Management should consider removing access rights to release background jobs under any user in production environment.

### **Management Response:**

#### ***Parks Forestry & Recreation***

Batch process functionality was assigned to one of the PFR SAP PM Sustainment security role to run background data loads. The purpose of batch process functionality is to help eliminate the stress and demand on the Production (PRD) environment when performing data load of large data sets in PRD (during regular business hours). This process was used at the time of PFR SAP PM Implementation and has not been used since. The SAP PM Sustainment team will re-assess its data loading practices and examine alternate ways to load large volume of data with minimum impact to PRD e.g. removing batch processes and loading data directly to PRD after regular business hours.

## **2.10 SAP Application Controls in Procurement Process – Automated Configuration Controls**

### **Observation:**

Based on our review of automated system configuration controls related to procurement processing it was noted that Item Categories and Accounts Assignment Categories in SAP are not configured to prevent the individual from modifying the GR (Goods receipt) and IR (invoice receipt) indicator fields.

### **Impact:**

Goods receipts and invoice receipt may not be recorded appropriately for purchase orders which can result in a misstatement in accrued liabilities.

### **Recommendation:**

Management should consider configuring the GR and IR indicator fields as non-changeable (binding) for Account Assignment Categories that require a 3-way match of purchase order, goods receipt and invoice receipt. This will require those purchases to follow the 3-way match functionality within SAP and not allow users to circumvent this matching process.

### **Management Response:**

#### ***Finance***

We agree with your observation. We will review the system configuration and make changes as appropriate.

### **3 Toronto Police Services (TPS)**

#### **3.1 Payroll - Timesheet approval process**

**Observation:**

During our testing of controls within the payroll cycle we noted that staff members in a supervisory capacity at Toronto Police Services (TPS) are authorized to approve their own time sheet.

**Impact:**

Employees may be paid based on hourly information that is either invalid or inaccurate.

**Recommendation:**

Management should consider revising the configuration in the payroll system to ensure that adequate segregation of duties exists with respect to the preparation and approval of time sheets for all employees. Alternatively, if this is not possible then management should consider implementing a process requiring the review and approval of timesheets for staff members in a supervisory capacity.

**Management Response:**

Please refer to the attached letter from TPS dated June 1, 2011.

#### **3.2 Information Technology – Dormant User Accounts**

**Observation:**

In the SAP Basis security testing, PwC noted user accounts in the TPS division that have never logged into the production environment, client 200, or have not logged into the system within the last three months.

**Impact:**

New user accounts which lay dormant with standard initial password accounts may lead to unauthorized access to the system. In addition, dormant user accounts may be creating unnecessary SAP licenses (and costs).

**Recommendation:**

Management should consider monitoring the dormant user accounts on a periodic basis, including dormant substitute user accounts, and deleting these accounts where appropriate

**Management Response:**

Please refer to the attached letter from TPS dated June 1, 2011.

### 3.3 Information Technology – Periodic User Access Rights Review

**Observation:**

PwC noted that SAP user divisions have daily processes in place for granting and removing access; however, there is no periodic review of access rights compared to user job responsibilities in SAP.

**Impact:**

Access that is not in accordance with job responsibilities may result in unauthorized activities and conflicts in segregation of duties.

**Recommendation:**

Management should consider requiring the SAP user department manager to perform a review of the access rights for each user on a periodic basis, at least annually, which includes a confirmation of the employment status based on each employee’s user ID and comparison of the level of access with their current job responsibilities.

**Management Response:**

Please refer to the attached letter from TPS dated June 1, 2011.

### 3.4 Information Technology – SAP Application Controls in Procurement Process – Sensitive Analysis/Segregation of Duties

**Observation:**

Based on our review of the segregation of duties and access to sensitive authorization related to procurement processing it was noted that 8 user accounts for operations support have access to transactions that provide conflicting abilities, and that 6 of these 8 user accounts have end-to-end access in the procurement business process. We understand that Finance management are aware of these conflicting duties for these 8 user accounts and accept the risks since these 8 user accounts are not performing any day-to-day transactions but provide operations support as needed.

However, PwC also noted several user accounts in addition to these 8 accounts above having conflicting duties as noted below:

#	Segregation of Duties Conflict	Impact
1	The functions to create or change General Ledger master data and process FI invoices are not segregated within the SAP system.	Individuals may create fictitious general ledger accounts and process FI invoices for the same account.
2	The functions to create or change an invoice and the release of a blocked invoice are not segregated within the SAP system.	Individuals may create or change fictitious invoice and process the same invoice without prior approval.
3	The functions to create or change an invoice and the creation, change or release of a purchase order are not segregated within the SAP system.	Individuals may create or change a fictitious purchase order and process an invoice for the same purchase order.

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#	Segregation of Duties Conflict	Impact
4	The functions to process a goods receipt and process an invoice are not segregated within the SAP system.	Individuals may process an invoice upon fictitious goods receipt.

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**Recommendation:**

Management should consider segregating the conflicting duties from user accounts' job responsibilities.

**Management Response:**

Please refer to the attached letter from TPS dated June 1, 2011.



## Toronto Police Service

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William Blair  
Chief of Police

File Number: .....

June 1, 2011

PricewaterhouseCoopers LLP  
Mississauga Executive Centre  
1 Robert Speck Parkway Suite 1100  
Mississauga, Ontario  
L4Z 3M3

Dear Michael Hawtin:

Thank you for providing us with your management letter on the audit of consolidated financial statements for the City of Toronto, for the year ending December 31, 2010.

We have thoroughly reviewed the report and believe the key audit findings provide many opportunities for the Service to improve upon the existing internal controls. We would like to thank you for the four recommendations you have provided to address the concerns within the report, and to confirm on behalf of the Service our commitment to continuing to work together with the City of Toronto to ensure the financial aspects of the operations remain effective and efficient.

With respect to the recommendation relating to the payroll timesheet approval process, we recognize that adequate segregation of duties should exist with respect to the preparation and approval of timesheets for all employees. The direction for those in a management capacity is to have their immediate supervisor authorize their timesheet entries. Several meetings and presentations were provided to supervisors by Human Resources Information Services (HRIS) staff on how to effectively administer and manage timesheets. Although this is the applicable procedure, it has been determined that not all members can comply as in the cases of the Chief, Deputies, Superintendents and Directors. As a result, HRIS has put in place a series of system audits to be used to track timesheet entries and approvals for any inconsistencies which can then be reviewed

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and corrected in order to avoid employees being paid on hourly information that is either invalid or inaccurate.

As you have noted in recommendation two, it is important to ensure that management consider monitoring the dormant user accounts on a periodic basis, including dormant substitute user accounts, and deleting these accounts where appropriate. Most TPS users who are on the dormant list are substitute users (usually having a back-up approver role), who would log on to SAP, as required, when main users are away on holidays. The dormant users' list is reviewed on a monthly basis. Dormant users' unit assignment is checked against their job role assignment to ensure the user has not moved to another unit; should this be the case, the user's access is deleted. Dormant users are reminded to log on to the system if access is required, or to advise SAP Administrators if SAP access is no longer part of their area of responsibility so access can be deleted. It has been the usual practice to provide a different initial password to new users on a monthly basis to prevent unauthorized access to the system through the standardized initial passwords and/or unnecessary SAP licences and costs.

With respect to recommendation three, Periodic User Access Rights Review, the Service has numerous job roles that are specific to a user's job responsibilities which prevent unauthorized activities and conflicts in segregation of duties. The assigned job roles provide users authorization for specific transactions. Users with procurement capabilities have authorization to create purchasing documents for their unit only, and are subject for release by their respective approvers only. All employee movement from one unit to another, as well as resignations, retirements and terminations are published in Routine Orders. All published names are checked against SAP user access. Job roles are checked, reviewed and necessary action is undertaken to maintain the user's level of authorization. Access assessment and/or deletion are authorized based on: TPS Routine Orders, a daily internal notification which includes all employee transfers and retirements/resignations/terminations, in addition to notifications from TPS-Information Technology Services (ITS) Computer Access to all system administrators of resignations and retirements and E-mails from unit commanders.

Lastly, with regards to recommendation four, the Service is committed to SAP application controls in the procurement process including sensitive analysis and segregation of conflicting duties from user accounts' job responsibilities. Financial Management is aware of eight user accounts for operations support that have access to transactions that provide conflicting abilities, and that six of these eight user accounts have end-to-end access in the procurement business process. We accept the risks since these eight user accounts are not performing any day-to-day transactions but provide operations support as needed. With regards to the additional accounts which have conflicting duties, the Service has responded to these issues in the following manner:

- a) The ability for individuals to create fictitious general ledger accounts and process Financial Accounting (FI) invoices due to a lack of segregation within the SAP system for the same account is no longer available. The functions to create or

change General Ledger master data has been removed from the Service's affected roles as of November 2010 and replaced with display only access for users.

- b) The ability for individuals to create or change an invoice and the release of a blocked invoice are designated within the SAP system through the temporary user block, or system block due to GR/IR differences. The function of releasing system blocked invoices is assigned to the Financial Accounting, accounts payable supervisor's role (TPS\_FI-AP-SUPERVISOR). Due to the limited number of staff, this role is assigned to four users in the Financial Management area: the accounting supervisor, as the main user and, the manager and two assistant managers for back-up purposes. This method of segregation would prevent individuals from creating or changing fictitious invoices and processing the same invoice without prior approval.
- c) The ability for individuals to create or change an invoice and the creation, change or release of a purchase order have been amended by the Service in order to segregate duties within the SAP system. TPS users with the ability to change a purchase order are limited to unit administrative coordinators who do not have the ability to create or change invoiced documents which could result in creating or changing a fictitious purchase order and/or processing an invoice for the same purchase order.
- d) The ability for individuals to process a goods receipt and process an invoice in SAP is currently a segregated duty. TPS users who process invoices do not have the ability to gain access to goods receipts. Though accounting users may have the MIGO (goods receipt for a purchase order) transaction code through another role, it has been set up for display purposes only, thereby preventing any individual from processing an invoice based on a fictitious goods receipt.

Finally, the Service accepts the report and will evaluate the recommendations to further improve our internal controls.

Respectfully submitted,



William Blair, O.O.M.  
Chief of Police

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- cc: Dr. Alok Mukherjee, Chair, Toronto Police Services Board  
Deputy Chief Peter Sloly, Executive Command  
Deputy Chief Michael Federico, Human Resource Command  
Inspector Stuart Eley, Executive Officer

Kristine Kijewski, Director, Corporate Services  
Angelo Cristofaro, Director, Finance & Administration  
Dana Styra, Manager, Audit & Quality Assurance

## ***Appendix F: Public Sector Accounting - What's new?***

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## **a. Government Transfers**

As previously communicated, in December 2010 PSAB approved a final standard to replace existing Section PS 3410, Government Transfers. The revised Section PS 3410 has been issued in February 2011 and will be effective for fiscal years beginning on or after April 1, 2012.

*The most significant impact to the City is likely around the accounting for grants received for tangible capital assets. There will likely be little opportunity to defer government grant transfers received and not spent unless they meet the definition of a liability.*

## **b. Financial Instruments and Financial Statement Presentation**

In March 2011 PSAB approved section PS 3450, Financial Instruments, and will be effective for periods beginning on or after April 1, 2012 for government organizations and April 15, 2015 for governments. The new section provides guidance on the recognition, measurement, presentation and disclosure of financial instruments. Financial assets and/or financial liabilities are to be recognized when the entity becomes a party to a financial instrument contract. Derivatives and portfolio investments that are equity instruments quoted in an active market are to be measured at fair value. The entity may report non-derivative financial assets and/or financial liabilities on a fair value basis if it manages and reports performance of these items on a fair value basis. The change in fair value of the items is recognized in the statement of remeasurement gains and losses until settlement.

In March 2011 PSAB approved section PS 1201 which replaces section PS 1200, Financial Statement Presentation, and will be effective for periods beginning on or after April 1, 2012 for government organizations and April 15, 2015 for governments. The new Section includes a statement of remeasurement gains and losses which will report; unrealized gains and losses with the change in fair value of financial instruments; exchange gains and losses associated with monetary assets and monetary liabilities denominated in foreign currency that have not been settled; amounts reclassified to the statement of operations upon derecognition or settlement; and other comprehensive income reported when an entity includes the results of its government business enterprises and government business partnerships in the summary financial statements.

*The most significant impact to the City will be the presentation of the change in the fair value of the derivative financial instruments for its purchase of electricity and natural gas as well for the change in the fair value on the interest rate swaps at TCHC. The change in the fair value will now be recognized in the statement of remeasurement gains and losses and no longer in the consolidated statement of operations and accumulated surplus.*

*In addition there will be an impact on the City's investments which are currently being recorded at cost, and will need to be recorded at fair value with the change in the fair value being recognized in the statement of remeasurement gains and losses*

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## c. Other Projects

Other previously communicated projects are in progress for PSAB:

- Amalgamation and government restructuring – A project was approved in March 2009 to issue an accounting standard that addresses the definition and classification of amalgamation and restructuring activities; the recognition criteria and accounting treatment of various elements of the amalgamation and restructuring transaction; the measurement basis of assets and liabilities involved; and the disclosure requirements unique to amalgamation and restructuring. An exposure draft is expected to be approved and issued in September 2011.
- Assets – Section PS 3200 addresses the basic concepts and key terms in the definition of liabilities with further guidance, examples and indicators. It also establishes the recognition and disclosure standards for liabilities. Similar standards on assets would be useful not only for financial statement preparers and auditors in application and interpretation of the definition of assets, but also for the development of future standards on specific assets. The objective of this project is to provide guidance relating to the key terms in the definition and essential characteristics of assets, define contingent assets and contractual rights, provide recognition and derecognition criteria for assets and contingent assets, provide guidance on the measurement of assets and contingent assets (including impairments) and provide guidance on the disclosure of assets, contingent assets and contractual rights. PSAB approved the project proposal in June 2009 and a statement of principles is expected to be approved in June 2011.
- Related Party Transactions and Appropriations – PSAB approved a project proposal in September 2010 to issue a new accounting standard covering related party transactions and appropriations. The objectives of the project are to define related parties and appropriations in the context of government and government organizations; describe the disclosures required; and address recognition and disclosure appropriations. . Our audit national public sector leader is a member of this PSAB task force.

*The City will need to monitor these projects for future impact on their own financial reporting.*

