

**Toronto Transit Commission**  
Year-end Report to the Audit Committee  
December 31, 2010

Prepared as at April 11, 2011

April 11, 2011

Commissioner Denzil Minnan-Wong  
Chair of the Audit Committee of the Toronto Transit Commission  
Toronto Transit Commission  
1900 Yonge Street  
Toronto, Ontario  
M4S 1Z2

Dear Commissioner Minnan-Wong:

We have substantially completed our audit of the consolidated financial statements of the Toronto Transit Commission (the TTC) for the year ended December 31, 2010 and propose to issue an unqualified report on those consolidated financial statements, pending resolution of the outstanding items outlined on page 1. Our draft auditor's report has been 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 on the significant accounting and financial reporting items dealt with in completing our audit procedures.

We propose to review the key elements of this report with you at our upcoming meeting and will discuss our key findings with the audit committee.

We would like to express our sincere thanks to the management and staff of the TTC who have assisted us in carrying out our work and we look forward to meeting with you on April 19, 2011.

Yours very truly,

*PricewaterhouseCoopers LLP*

Cathy Russell  
Partner  
Audit and Assurance Group

cc: Members of the Audit Committee  
Mr. Vincent Rodo, General Manager – Executive and General Secretary  
Mr. Michael Roche, Chief Financial Officer

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We have issued the accompanying report to assist members of the Audit Committee of the Toronto Transit Commission (TTC) in their review of the consolidated financial statements of the TTC. As the TTC's auditor, our primary responsibility is to form and express an opinion on the TTC's consolidated financial statements for the year ended December 31, 2010. The consolidated financial statements are prepared by management with the oversight of those charged with governance (audit committee). An audit of the consolidated financial statements does not relieve management or the audit committee of its responsibilities. 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. 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.

# 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 on 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.

Outstanding items as at April 11, 2011	Status as at April 19, 2011
i. City of Toronto confirmation of amounts payable to the TTC, including support for any reconciling items	
ii. SunLife bridge letter supporting the adequacy of controls from October 1 <sup>st</sup> to December 31 <sup>st</sup> at this 3 <sup>rd</sup> party service provider	
iii. Responses to our legal confirmation letters from external legal counsel	
iv. Various general queries of management and miscellaneous outstanding information relating to audit work in progress	
v. Completion of subsequent events procedures	
vi. Receipt of signed management representation letter	
vii. Reading of annual report	
viii. Approval of the consolidated financial statements by the audit committee	

## b. Key matters 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 the respective page references in the table of contents below.

Issue	Summary discussion	For further reference
i.	<p>Revenue Recognition</p> <ul style="list-style-type: none"> <li>• The TTC has several significant revenue streams. We have completed our audit procedures relating to all of the significant revenue streams.</li> <li>• Based on our work performed, we have concluded that the revenue recorded on the TTC's consolidated financial statements has been appropriately recognized.</li> </ul>	Page 4
ii.	<p>Significant Accounting Estimates</p> <ul style="list-style-type: none"> <li>• In preparing the consolidated financial statements there were a number of significant accounting estimates that required management judgment</li> <li>• Based on our audit work performed, we have concluded that the significant accounting estimates detailed within this report are supportable and within our expectations.</li> </ul>	Page 5
iii.	<p>Management Override of Controls</p> <ul style="list-style-type: none"> <li>• In completing our audit, we are responsible for maintaining professional skepticism and considering the potential for management override of controls.</li> <li>• Based on our audit work performed, we found no circumstances that evidenced inappropriate management override of controls.</li> </ul>	Page 6
iv.	<p>Capital Accounting for Transit City</p> <ul style="list-style-type: none"> <li>• In the current year additional clarification was obtained regarding the Transit City assets and the associated capital subsidy. As a result, all capital assets relating to the approved Transit City lines have not been included in the consolidated financial statements of the TTC.</li> </ul>	Page 6
v.	<p>Depreciation of Capital Assets</p> <ul style="list-style-type: none"> <li>• Capital asset depreciation is estimated at the beginning of the year and is recorded based on budgeted unsubsidized capital asset additions.</li> <li>• Subsequent to December 31, 2010, an analysis was completed by management which determined that the current year depreciation expense recorded by the TTC was overstated by \$2.8 million.</li> <li>• Also in the current year, management noted that historically, computer assets, not yet in productive use, were being incorrectly depreciated. This resulted in a \$3.7 million overstatement of depreciation expense in 2009 and \$6.3 million overstatement of depreciation</li> </ul>	Page 7

Issue	Summary discussion	For further reference
	<p>expense relating to earlier years. An adjustment to correct this over-depreciation has been reflected by management in the current year consolidated financial statements.</p> <ul style="list-style-type: none"> <li>Both of these adjustments have been reflected in Appendix B of this report.</li> </ul>	
vi.	<p>Summary of adjusted and uncorrected misstatements</p> <ul style="list-style-type: none"> <li>We identified certain uncorrected misstatements during the course of our audit examination. No adjustments were made by management as a result of our audit.</li> <li>As detailed in Appendix B, net operating surplus is overstated by \$8.3 million in the current year as compared to overall materiality of \$19.5 million.</li> <li>In our opinion, the consolidated financial statements, taken as a whole, are free of material misstatement.</li> </ul>	Page 8 and Appendix B
vii.	<p>Fraud</p> <ul style="list-style-type: none"> <li>No instances of fraud were noted as part of our audit procedures.</li> <li>We wish to confirm whether the audit committee is aware of any known, suspected or alleged incidents of fraud.</li> </ul>	Page 9
viii.	<p>Control deficiencies</p> <ul style="list-style-type: none"> <li>We have noted several internal control recommendations which we have brought to the attention of management</li> </ul>	Page 10 and Appendix E
ix.	<p>Independence</p> <ul style="list-style-type: none"> <li>We confirm that we are independent of the TTC as at April 19, 2011, and our independence letter can be found in Appendix C.</li> </ul>	Appendix C
x.	<p>Management representations</p> <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 management representation letter is included in Appendix D.</li> </ul>	Appendix D

## 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 company's reported results.

We are responsible for discussing with the audit committee our views about the significant qualitative aspects of the TTC'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 areas of judgment and significant audit risks:

Item 1	Revenue Recognition
<p><b>Background information and management's process</b></p>	<p>The TTC has several significant revenue streams from the following sources:</p> <ul style="list-style-type: none"> <li>o Passenger Revenue</li> <li>o Property Rental Revenue</li> <li>o Outside City Service Revenue</li> <li>o Advertising Revenue</li> </ul> <p>The TTC has established revenue recognition policies in accordance with Canadian Generally Accepted Accounting Principles (GAAP). 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. In addition, the TTC has numerous processes and controls in place to ensure that revenue is appropriately measured and recognized.</p>
<p><b>PwC views</b></p>	<p>Through our meetings with management, we obtained an understanding of the processes and controls in place surrounding revenue recognition. As part of these meetings, we also reviewed and assessed the appropriateness of the accounting policies adopted by the TTC for recognizing revenue and ensured all accounting policies are in accordance with Canadian GAAP.</p> <p>For passenger revenue we identified and tested a number of key internal controls. Specifically controls around cash, token and ticket collection, fare media issuance and the reconciliation of token vending machines were tested on a sample basis. No exceptions were noted in the testing of these controls.</p> <p>For property rental, outside city service and advertising revenue, we agreed a sample of revenue transactions from each of these three sources to supporting documentation. In addition, we also performed substantive analytics over passenger revenue and other revenue streams. For each, we set independent expectations for the year-to-date revenue amounts based on prior year's results taking into account fare increases and changes in ridership.</p>

<b>Item 1</b>	<b>Revenue Recognition</b>
<b>Conclusion</b>	Based on our audit work performed, we have no matters to report with respect to revenue recognition.
<b>Item 2</b>	<b>Significant Accounting Estimates</b>
<b>Background information and management's process</b>	<p>In preparing the consolidated financial statements there were a number of significant accounting estimates that required management's judgment, including the following:</p> <ul style="list-style-type: none"> <li>o Deferred passenger revenue</li> <li>o Post-employment and post-retirement benefits (pension and other)</li> <li>o Unsettled accident claims</li> <li>o Contingent liabilities (provisions for legal claims)</li> </ul> <p>Management has processes and controls in place for formulating these estimates. Where applicable, management has engaged external specialists to assist in the determination of these significant accounting estimates. In particular, the TTC has contracted external specialists to assist with the valuation of post-employment and post-retirement benefits and accident claim liabilities.</p>
<b>Subjective estimates / areas of judgment by management</b>	<p>Significant estimates and areas of judgment made by management are as follows:</p> <ul style="list-style-type: none"> <li>• Deferred Revenue - Token and ticket loss factors as well as estimating the dollar amount of fare media in the custody of TTC collectors at year-end.</li> <li>• Post-employment and post-retirement benefits – Discount rates used to present value the post-employment and post-retirement benefit obligations are 4.4% and 5.5%, respectively. Numerous other actuarial assumptions such as mortality rates, retirement age etc. are also incorporated in the valuation of these liabilities.</li> </ul> <p>Unsettled accident claims – The measurement of the unsettled accident claims liability uses a number of estimates and actuarial assumptions, including a discount rate of 2.15% to present value future settlements. The actuary has incorporated claims provisions for adverse deviations (PFAD) within a reasonable range and has also incorporated an appropriate internal loss adjustment expense.</p> <ul style="list-style-type: none"> <li>• Contingent liabilities (provisions for legal claims) – The TTC is subject to a number of legal claims, in connection with operations, labour relations and the completion of capital projects. Management uses all information available including the assessment and likelihood of a claim by external counsel and historical experience to record provisions for what management believes is the most accurate estimate of future settlement based on the current known facts.</li> </ul>
<b>PwC's views</b>	<ul style="list-style-type: none"> <li>• Deferred Revenue - We met with TTC management to understand the process for establishing the deferred revenue provision. As part of the audit, we tested the key assumptions and concluded that all assumptions used in the calculation were supportable and reasonable.</li> <li>• Unsettled accident claims – Our PwC actuarial specialists assessed the reasonableness of the assumptions and methodology used by the TTC in recording the unsettled accident claims liability. We tested the accuracy and completeness of the data used in the calculation and our specialists independently projected a reserve estimate which was compared it to the estimate recorded by the TTC. No significant differences were noted.</li> </ul>

Item 2	Significant Accounting Estimates
	<ul style="list-style-type: none"> <li>• Post-employment and post-retirement benefits – We reviewed the third party actuarial valuations of the post-employment and post-retirement benefit plans at year-end with the assistance of our PwC specialists to assess the appropriateness of the assumptions and methodology used to record the post-retirement and post-employment liabilities. No significant matters were noted.</li> <li>• Contingent liabilities (provisions for legal claims) - We obtained independent legal confirmations letters from all external counsel to obtain third party confirmation on the status of outstanding legal proceedings and discussed significant cases with internal counsel and management. We will ensure that the provision recorded at year-end is supported by the conclusions reached in the external confirmations received.</li> </ul>
<b>Conclusion</b>	<ul style="list-style-type: none"> <li>• Based on the testing performed above, we conclude that these significant accounting estimates are reasonable and have been recorded in accordance with Canadian GAAP</li> </ul>
Item 3	Management Override of Controls
<b>Background information and management's process</b>	<ul style="list-style-type: none"> <li>• In completing our audit, we are responsible for maintaining professional skepticism throughout our audit engagement, considering the potential for management override of controls.</li> <li>• Management has a process to ensure appropriate segregation of duties has been established at the TTC in order to mitigate the risk of management override of controls.</li> <li>• The TTC has policies in place to prevent and detect fraud, including a code of conduct, an internal audit department and a process to ensure the review and approval of manual journal entries.</li> </ul>
<b>PwC's views</b>	<ul style="list-style-type: none"> <li>• Through our audit procedures we did not note any circumstances where we believe there was inappropriate segregation of duties.</li> <li>• We performed audit work on a sample of significant and non-standard manual journal entries. We obtained documentation to support the manual entries selected and also confirmed that all were appropriately approved.</li> </ul>
<b>Conclusion</b>	<ul style="list-style-type: none"> <li>• Based on our work performed, we found no circumstances that evidence inappropriate management override of controls.</li> </ul>
Item 4	Capital Accounting for Transit City
<b>Background information and management's process</b>	<ul style="list-style-type: none"> <li>• On April 1, 2009, the Province of Ontario announced funding for four Transit City lines. Management has indicated that the original intention was that the TTC and the City would not be required to contribute towards the costs of these dedicated Transit City lines.</li> <li>• At December 31, 2009, the TTC recorded capital assets and corresponding capital contributions, based on the Transit City assets acquired during the year, totaling \$28.7 million in the consolidated financial statements.</li> <li>• During fiscal 2010, Metrolinx, the TTC and the City negotiated and made progress towards finalizing the Master Agreement for Transit City. Property, procurement,</li> </ul>

Item 4	Capital Accounting for Transit City
	<p>financial and communications protocols were drafted and established in principle detailing issues of ownership, contracting, invoicing and liability. We understand that it was agreed that Transit City assets would be owned by Metrolinx, which is consistent with the original Memorandum of Agreement signed in 2009. Through the current year, additional project funding of \$77.4 million has been drawn through the City to subsidize 2010 expenditures.</p> <ul style="list-style-type: none"> <li>• At December 31, 2010, no formal Master Agreement had yet been executed with Metrolinx. However, with an improved understanding of how the Master Services Agreement is to be finalized, TTC management made the decision to remove the capital assets of \$28.7 million previously capitalized in the consolidated financial statements of the TTC and the corresponding capital subsidy.</li> <li>• At December 31, 2010, total eligible expenditures of \$106.1 million incurred to date on capital assets relating to the approved Transit City lines are not included in the consolidated financial statements of the TTC as these assets are the property of Metrolinx.</li> </ul>
<b>PwC's views/ Conclusion</b>	<ul style="list-style-type: none"> <li>• As management's presentation is consistent with the Memorandum of Agreement dated November 2009 and subsequent extension letters to May 2011, we agree with management's treatment.</li> <li>• The TTC has been fully subsidized by the City for all eligible expenditures incurred to date.</li> </ul>
Item 5	Depreciation of Capital Assets
<b>Background information and management's process</b>	<ul style="list-style-type: none"> <li>• Consistent with prior years, capital asset depreciation, for assets not subject to subsidy, is recorded based on budgeted capital additions.</li> <li>• At the beginning of each year, as part of the budgeting process, Capital Project Managers estimate whether the unsubsidized projects for which they are responsible will be completed and put into productive use during the year.</li> <li>• Based on this information a monthly depreciation charge is estimated and recorded throughout the year.</li> <li>• Subsequent to year-end, management completed an analysis to compare actual to budgeted transfers of unsubsidized capital assets from construction-in-progress to the productive asset accounts. In completing this analysis, management determined that the current year depreciation expense was overstated by \$2.8 million.</li> <li>• Also in the current year, management noted that in prior years, information technology assets, not yet in productive use, were being depreciated. This resulted in a \$3.7 million overstatement of depreciation expense in 2009 and \$6.3 million in earlier years. On the basis of materiality, management did not adjust prior periods, but rather recorded an adjusting journal entry in the current year to reverse the full \$10 million of depreciation on those information technology assets.</li> </ul>
<b>PwC's views/ Conclusion</b>	<ul style="list-style-type: none"> <li>• Both of the adjustments noted above have been reflected in our summary of uncorrected misstatements in Appendix B of this report.</li> <li>• We accept management's position relating to the depreciation adjustment for prior years.</li> </ul>

### 3. Summary of adjusted and uncorrected 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 misstatements and have discussed these with management. A summary of these items has been included in Appendix B. No adjustments were made by management as a result of our audit.

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 TTC.

<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 management representation letter is included in Appendix D.</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>
Other information in documents containing audited financial information	<ul style="list-style-type: none"> <li>• Once completed, we will review the Annual Report for consistency with the audited financial statements.</li> </ul>
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none"> <li>• No difficulties or disagreements 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 auditors for 2010.</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 TTC'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 TTC improve the system of internal control and achieve operational efficiencies. See Appendix E for a copy of our management letter.

## 6. 2010 audit fees

### Fees

The fees detailed below are in accordance with our response to the City's Request for Proposal covering the five year contract period for the years ended December 31, 2010 through to 2014.

<b>Service description</b>	<b>Actual fees for year ended December 31, 2010 \$</b>
Audit of the TTC consolidated financial statements	57,840
Audit of the Toronto Coach Terminal Inc. financial statements	4,880
Audit of the TTC Insurance Company Ltd. financial statements	11,750
<b>Total</b>	<b>74,470</b>

## Appendix A:

### Draft Auditor's Report

## Appendix A: Draft Auditor's Report

### To the Chair and Members of the Toronto Transit Commission

We have audited the accompanying consolidated financial statements of the **Toronto Transit Commission** which comprise the consolidated balance sheet as at December 31, 2010 and the consolidated statements of operations and accumulated equity and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of the 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 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 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 Toronto Transit Commission as at December 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

#### **Other matter**

The consolidated financial statements as at December 31, 2009 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 25, 2010.

The accompanying consolidated financial statements schedule as at and for the year ended December 31, 2010 is presented as supplementary information only and is not a required part of the basic consolidated financial statements. The information in this schedule has been subject to audit procedures only to the extent necessary to express an opinion on the consolidated financial statements of the Toronto Transit Commission.

#### **DRAFT**

**Chartered Accountants, Licensed Public Accountants**  
**Toronto, Canada**  
**April 19, 2011**

## Appendix B:

# Summary of Adjusted and Uncorrected Misstatements

## Appendix B: Summary of Adjusted and Uncorrected Misstatements

### i) Summary of uncorrected misstatements

<i>(all amounts in thousands)</i>	Statement of Operations	Balance Sheet		
Description	Operating surplus Over/(Under) Stated	Assets (Over)/Under Stated	Liabilities Over/(Under) Stated	Opening Accumulated Equity Over/(Under) Stated
<b><i>Current year unadjusted Misstatements</i></b>				
Confidential matter	(3,580)		3,580	
Overstatement of depreciation expense and understatement of net capital assets. Current year operating surplus understated.	(2,786)	2,786		
Overstatement of prior year depreciation corrected in the current year. Current year operating surplus overstated.	10,086			(10,086)
<b>Total unadjusted differences before impact of reversal of prior year differences</b>	<b>3,720</b>	<b>2,786</b>	<b>3,580</b>	<b>(10,086)</b>
<b><i>Reversal of prior year unadjusted misstatements</i></b>				
Reversal of prior year accruals noted by E&Y which flow through current period operations	4,565			(4,565)
<b>Total Unadjusted Differences</b>	<b>8,285</b>	<b>2,786</b>	<b>3,580</b>	<b>(14,651)</b>

### ii) Summary of adjusted misstatements

No adjustments were recorded by the TTC as part of the audit process.

## Appendix C: Independence Letter

April 19, 2011

Commissioner Denzil Minnan-Wong  
Chair of the Audit Committee of the Toronto Transit Commission  
Toronto Transit Commission  
1900 Yonge Street  
Toronto, Ontario  
M4S 1Z2

Dear Commissioner Minnan-Wong:

We have been engaged to audit the consolidated financial statements of the Toronto Transit Commission (the TTC) for the year ended December 31, 2010.

Canadian generally accepted auditing standards require that we communicate at least annually with you regarding all relationships between the TTC, 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 Ontario 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) audit committee approval of services; and
- (h) provision of services in addition to the audit engagement.

We are not aware of any relationships between the TTC or its management and PricewaterhouseCoopers LLP that may reasonably be thought to bear on our independence, that have occurred from January 1, 2010 to April 19, 2011.

We hereby confirm that we are independent with respect to the TTC within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of April 19, 2011.

This report is intended solely for the use of the audit committee, the Commission, management, and others within the TTC 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.

Yours very truly,

*PricewaterhouseCoopers LLP*

**Chartered Accountants, Licensed Public Accountants**

c.c.: Members of the Audit Committee

Appendix D:  
Management Representation Letter

## DATE

PricewaterhouseCoopers LLP  
Royal Trust Tower  
TD Centre, Suite 3000  
Toronto, Ontario  
M5K 1G8  
Attention: Cathy Russell

Dear Sirs

We are providing this letter in connection with your audit of the consolidated financial statements of the Toronto Transit Commission (TTC or Commission) 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 TTC in accordance with Canadian generally accepted accounting principles.

**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 generally accepted accounting principles;
- We are responsible for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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 generally accepted accounting principles;
- 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 generally accepted accounting principles and disclosures otherwise required to be included therein by the laws and regulations to which the TTC 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 a statement of operations account and vice versa. All inter-

company 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 TTC'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 TTC's particular circumstances to present fairly in all material respects its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles.

### **4. Internal controls over financial reporting**

We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the TTC is made known to us by others.

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

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:

- a. Contracts and related data;
- b. Information regarding significant transactions and arrangements that are outside of the normal course of business;
- c. Minutes of the meetings of the Commission.

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 TTC 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 TTC 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 TTC's consolidated financial statements, communicated by employees, former employees, analysts, 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, as defined as CICA Handbook Section 5136.

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

Significant assumptions used by the TTC 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 TTC'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 Canadian Institute of Chartered Accountants (CICA) Handbook Section 1508, Measurement Uncertainty and CICA Handbook Section 3862, Financial Instruments – Disclosures, 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 CICA Handbook Section 3840, Related Party Transactions, which include, but are not limited to directors, officers, senior members of management, or immediate family members of such individuals, or entities over which these individuals are able to exert significant influence. We also confirm the completeness of information provided to you regarding the nature of the TTC's relationships with and transactions involving those entities.

The identity and relationship of and balances and transactions with related parties have been properly recorded and adequately disclosed in the consolidated financial statements, as required by Canadian generally accepted accounting principles.

The list of related parties attached to this letter as Appendix A accurately and completely describes the TTC'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 business or to cease operations).

**12. Assets and liabilities**

We have satisfactory title or control over all assets. We have recorded or disclosed, as appropriate, all liabilities, in accordance with Canadian generally accepted accounting principles. All liabilities and contingencies, whether written or oral, under which the TTC is contingently liable in accordance with Accounting Guideline 14, *Disclosure of Guarantees*, or CICA Handbook Section 3290, *Contingencies*, 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 balance sheet date or exist now, have been disclosed to you and accounted for and disclosed in accordance with Canadian generally accepted accounting principles, 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. Solely for the purpose of this letter, the term "material" means any item referred to in this letter, individually or the aggregate that are more than \$19.5 million. 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, 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.

**15. Cash and banks**

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

All cash balances are under the control of the TTC, 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 TTC.

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

**16. Accounts receivable**

Amounts receivables amounted to \$563.7 million and are considered to be fully collectible and were free from hypothecation or assignment as security for advances to the TTC, except as hereunder stated.

Receivables recorded in the consolidated financial statements represent bona fide claims against debtors indicated and do not include amounts for services provided subsequent to the balance sheet date (except for receivables with a corresponding deferred revenue balance), or other types of arrangements not constituting sales. All revenue recognized as of the balance sheet date has been realized (or is realizable) and earned.

**17. Spare Party Inventory**

Spare parts inventory recorded in the consolidated financial statements are stated at the weighted-average cost, with due provision recorded to reduce all damaged, wholly or partially obsolete, usable or excess inventories to their estimated selling price less estimated cost to sell. Inventory quantities at the balance sheet date were determined from carefully kept records at year end. At least once during the year, these records were adjusted to reflect actual quantities on hand as ascertained by the actual count, weight or measurement by component employees under the supervision of management. Liabilities for amounts unpaid are recorded for all items included in inventories at balance sheet date.

**18. Property, Plant and Equipment**

All charges to property, plant and equipment asset accounts represented the actual cost of additions to property, plant and equipment. No significant property, plant and equipment additions were charged to repairs and maintenance or other expense accounts.

Book values of property, plant and equipment sold, destroyed, abandoned or otherwise disposed of have been eliminated from the accounts.

Property, plant and equipment assets owned by the TTC 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.

Based on the Memorandum of Agreement dated November 2009, total eligible expenditures of \$106.1 million incurred to date on capital assets relating to the approved Transit City lines have appropriately not been included in the consolidated financial statements of the TTC as these assets are the property of Metrolinx.

All lease agreements covering property leased by or from the TTC have been disclosed to you and classified as capital, operating, sales-type or direct financial leases as appropriate.

There have been no events or changes in circumstances that indicate the carrying value of a long-lived asset is not recoverable; accordingly management was not required to perform an impairment test in accordance with CICA 3063 "Impairment of Long-lived Assets" during the period. We believe that the carrying amount of the TTC's long-lived assets is fully recoverable.

**19. Financial Instruments**

The TTC has properly classified financial assets with readily determinable fair values as either held for trading, held-to-maturity, or loans and receivables. The TTC has positive intent and ability to hold to maturity all financial assets that are classified as held-to-maturity.

The TTC has properly classified financial liabilities with readily determinable fair values as either held for trading or other financial liabilities.

**20. Investment in subsidiaries and affiliates**

We have appropriately consolidated all entities for which we directly or indirectly have a controlling financial interest.

**21. Accounts Payable**

Amounts payable that are non-interest bearing and are expected to be paid more than a year after initial recognition date have been initially recognized at fair value, using an appropriate discount rate, and subsequently measured at amortized cost.

**22. Unearned revenue and deferred credits**

All material amounts of unearned revenue are appropriately recorded in the books and records.

### 23. Employee future benefits

All arrangements, whether formal or informal, explicit or implied, to provide retirement income and other post-retirement benefits to employees after they cease employment, have been identified to you and have been included in the actuarial valuation.

The details of all supplemental pension plan amendments since December 31, 2009, the date of the last full actuarial valuation for accounting purposes, have been identified to you.

The actuarial assumptions and methods used to measure liabilities and costs for financial accounting purposes for pension and other postretirement benefits are appropriate in the circumstances.

The TTC does not plan to make amendments to the pension or other post-retirement benefit plans that would have an impact on the current year consolidated financial statements.

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

The employee future benefit costs, assets and obligations have been determined, accounted for and disclosed in accordance with CICA 3461, *Employee Future Benefits* (as amended). In particular:

- i) The significant accounting policies that the TTC has adopted in applying CICA 3461 are accurately and completely disclosed in the notes to the consolidated financial statements.
- ii) Each of the best estimate assumptions used reflects management's judgment of the most likely outcomes of future events;
- iii) The best estimate assumptions used are, as a whole, internally consistent, and consistent with the asset valuation method adopted;
- iv) The discount rate used to determine the accrued benefit obligation was determined by reference to market interest rates 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.
- v) The assumptions included in the actuarial valuation are those that management instructed Mercer 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 CICA 3461.
- vi) 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.
- vii) The source data and plan provisions provided to the actuaries for preparation of the actuarial valuations are accurate and complete.
- viii) Transactions between the TTC and the plan during the period are complete and accurate.

Based on the characteristics of the TTC pension plan (the Pension Fund Society), we believe it has been appropriately accounted for and disclosed in accordance with CICA 3461, *Employee Future Benefits*. Disclosure on the contributions paid by the TTC to the Pension Fund Society is complete and accurate.

### 24. Environmental remediation liabilities

Provision has been made for any material loss that is probable from environmental remediation liabilities. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have

been adequately described in the consolidated financial statements.

We have disclosed to you all liabilities or contingencies arising from environmental matters. These liabilities or contingencies have been recognized, measured and disclosed, as appropriate, in the consolidated financial statements. The environmental liabilities included in the balance sheet represent our best estimate of the potential losses using the assumptions that we believe represent the expected outcomes of uncertainties. With respect to the valuation of related assets, we consider 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. Any commitments related to environmental matters have been measured and disclosed as appropriate, the consolidated financial statements.

**25. Asset Retirement Obligations**

The TTC has reviewed tangible long-lived assets, operating lease agreements and other agreements for associated asset retirement obligations (AROs), and have recognized related liabilities where required, in accordance with CICA 3110, *Asset Retirement Obligations*. The methods and assumptions used to measure the fair value of recorded AROs are appropriate and reasonable under the circumstances and utilize the best available information.

**26. Use of a specialist**

We assume responsibility for the findings of specialists in evaluating the employee benefit obligation and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the 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.

**27. Revenue Recognition**

The conditions, including reasonably dependable estimates, for use of percentage-of-completion accounting under generally accepted accounting principles are present.

**28.** We have reviewed the criteria for revenue recognition included in CICA 3400, *Revenue*, and EIC 141, *Revenue Recognition*, namely, evidence of arrangement, delivery, fixed price and collectability and is recognizing revenue in accordance with these standards.

**29.** We have fully disclosed to you all sales terms (whether written or oral), including all customer-acceptance provisions, rights of return or price adjustments, and all warranty provisions.

**30. Consolidations**

All significant intercompany transactions have been disclosed to you and properly eliminated in the consolidated financial statements.

**31. Events after balance sheet date**

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

Yours truly,

**Toronto Transit Commission**

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Mr. Gary Webster, Chief General Manger

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Mr. Vincent Rodo, General Manager – Executive and General Secretary

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Mr. Michael Roche, Chief Financial Officer

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Mr. Paul Buttigieg, Chief Accountant – Financial Services

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Ms. Sharon Tippett, Superintendent – Financial Statements

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Mr. Alex Cassar, Supervisor – Accounting Policy & Financial Reporting

**Appendix A – Listing of Related Parties**

City of Toronto's agencies, boards and commissions are as follows:

*Agencies, Boards and Commissions:*

- Board of Governors of Exhibition Place
- Board of Management of the Toronto Zoo
- Heritage Toronto
- The North York Performing Arts Centre Corporation
- The Sony Centre for the Performing Arts
- St. Lawrence Centre for the Arts
- Toronto Atmospheric Fund (TAF)
- Toronto Board of Health
- Toronto Community Housing Corporation (TCHC)
- Toronto Licensing Commission
- Toronto Police Services Board
- City of Toronto Economic Development Corporation c.o.b. Toronto Port Lands Company (TPLC previously TEDCO) after November 13, 2008
- Toronto Public Library Board
- Toronto Waterfront Revitalization Corporation (TWRC) (1/3rd proportionately)
- Yonge-Dundas Square
- Build Toronto Inc. (Incorporated November 13, 2008)
- Invest Toronto Inc. (Incorporated November 13, 2008)

*Arenas:*

- Forest Hill Memorial
- George Bell
- Leaside Memorial Community Gardens
- McCormick Playground
- Moss Park
- North Toronto Memorial
- Ted Reeve Community
- William H. Bolton

*Community Centres:*

- 519 Church Street
- Applegrove
- Cecil Street
- Central Eglinton
- Community Centre 55
- Eastview Neighbourhood
- Harbourfront
- Ralph Thornton
- Scadding Court
- Swansea Town Hall

*Business Improvement Areas:*

- Albion/Islington Square
- Annex-Dupont
- Bloor Annex
- Bloor by the Park
- Bloorcourt Village
- Bloordale Village Bloor Street
- Bloor West Village Bloor-Yorkville
- Cabbagetown
- Chinatown

- Church-Wellesley Village
- College Promenade
- Corso Italia
- Crossroads of the Danforth
- Danforth Mosaic
- Danforth Village
- Dundas West
- Dovercourt Village
- Downtown Yonge
- Eglinton Hill
- Emery Village
- Fairbank Village
- Forest Hill Village
- Gerrard India Bazaar
- Greektown on the Danforth
- Harbord Street
- Hillcrest Village
- Historic Queen East
- Junction Gardens
- Kennedy Road
- Kensington Market
- Kingsway
- Knob Hill Plaza
- Korea Town
- Lakeshore Village
- Liberty Village
- Little Italy
- Little Portugal
- Long Branch
- Mimico by the Lake
- Mimico Village
- Mirvish Village
- Mount Dennis
- Mount Pleasant
- Oakwood Village
- Pape Village
- Parkdale Village
- Queen Street West
- Regal Heights Village
- Riverside
- Roncesvalles Village
- Rosedale Main Street
- Sheppard East Village
- St. Clair Gardens
- St. Lawrence Market Neighbourhood
- The Beach
- The Danforth
- The Eglinton Way
- The Waterfront
- Toronto Entertainment District
- Trinity Bellwoods
- Upper Village
- Uptown Yonge
- Village of Islington
- Weston Village
- West Queen West

- Wexford Heights
- Wychwood Heights
- Yonge-Lawrence Village
- York-Eglinton

*Government business enterprises*

- Enwave Energy Corporation ("Enwave")
- TEDCO (prior to November 14, 2008)
- Toronto Hydro Corporation
- Toronto Parking Authority

The TTCs affiliates include the following:

- Toronto Coach Terminal Inc.
- Toronto Transit Commission Insurance Company Limited
- Toronto Transit Consultants Limited
- The TTC Sick Benefit Association
- The TTC Pension Fund Society

**Appendix B – Summary of Unadjusted Misstatements**

<i>(all amounts in thousands)</i>	Statement of Operations	Balance Sheet		
Description	Operating surplus Over/(Under) Stated	Assets (Over)/Under Stated	Liabilities Over/(Under) Stated	Opening Accumulated Equity Over/(Under) Stated
<b><i>Current year unadjusted Misstatements</i></b>				
Confidential matter	(3,580)		3,580	
Overstatement of depreciation expense and understatement of net capital assets. Current year operating surplus understated.	(2,786)	2,786		
Overstatement of prior year depreciation corrected in the current year. Current year operating surplus overstated.	10,086			(10,086)
<b>Total unadjusted differences before impact of reversal of prior year differences</b>	<b>3,720</b>	<b>2,786</b>	<b>3,580</b>	<b>(10,086)</b>
<b><i>Reversal of prior year unadjusted misstatements</i></b>				
Reversal of prior year accruals noted by E&Y which flow through current period operations	4,565			(4,565)
<b>Total Unadjusted Differences</b>	<b>8,285</b>	<b>2,786</b>	<b>3,580</b>	<b>(14,651)</b>

## Appendix E: Management Letter

April 19, 2011

Mr. Michael A. Roche  
Chief Financial Officer  
Toronto Transit Commission  
1900 Yonge Street  
Toronto, Ontario M4S 3B2

Dear Mr. Roche:

**Management Letter**  
**2010 Audit of Toronto Transit Commission**

We have substantially completed our audit examination of the Toronto Transit Commission (the TTC). 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 TTC 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.

## **APPENDIX**

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## **1. Toronto Transit Commission (TTC)**

### **1.1 Approval of utility invoices subsequent to payment**

#### **Observation**

In testing the accounts payable three-way match process, it was noted that all utility invoices (Enbridge Gas & Hydro) are being formally approved by operational staff subsequent to being paid. Management has noted that the reason for this is that these types of invoices are normally due within a few days of their receipt and are subject to a late payment penalty if they are not paid on time.

#### **Implication**

There is a risk that an incorrect amount would be paid. It may be difficult and time consuming to follow up on discrepancies subsequent to payment.

#### **Recommendation**

PwC recommends that all invoices be approved prior to payment. This is to ensure that in the event that there are discrepancies in the invoices, that they are communicated prior to payment.

#### **Management Response**

Given the short time frame that Accounts Payable (A/P) staff have to pay utility invoices from the date of their receipt, management believes that the current process which incorporates reasonable checks and reviews prior to making payment (explained below) is appropriate in order to avoid late payment charges. Management also notes that it has not had any difficulties resolving any discrepancies with any of the utility providers.

Before payment of these Enbridge Gas & Hydro invoices is made, A/P staff undertake a review of the reasonableness of billed amounts by referring to spreadsheets listing approved locations/accounts for each utility. Upon receipt of an invoice, A/P staff compare the invoice details with the appropriate spreadsheet to ensure that the locations/accounts being billed for do indeed belong to the TTC and that the accounts/locations/billing periods have not already been invoiced. Should a new location/account appear on an invoice, A/P staff request operational staff to confirm the validity of the new location/account. Once confirmation is received, this new information is added to the spreadsheet. If confirmation is not received (i.e. the location/account does not relate to TTC), then the payment is amended to exclude the applicable charge. Subsequent to this review, when more time is available, these invoices are formally signed off by operational staff. If any discrepancies are identified at this stage then the utility is contacted and appropriate adjustments are made.

## **1.2 Reconciliation of wages, salaries and benefits expense not prepared**

### **Observation**

During our testing it was noted that a reconciliation to compare the financial statement wages, salaries and benefits expense to the year-to-date totals in the payroll register is not completed.

### **Implication**

Without this reconciliation being completed, there is a risk that expenses can be misclassified between the wage, salaries and benefits expense and the materials, services and supplies expense.

### **Recommendation**

PwC recommends that a reconciliation between the financial statement wages, salaries and benefits expense and the payroll register be completed on a timely basis each month or quarter.

### **Management Response**

Compensating controls are in place to ensure that the wages, salaries and benefits expense that is reported in the financial statements is appropriately stated. For example:

- every pay period a cost analyst ensures that the total amount paid according to the payroll register is equal to the total labour component charged to the general ledger accounts which includes charges to the Capital Program, Wheel-Trans and TCTI. This process is done for each payroll. All differences are investigated and resolved; and
- the departmental budget analysts and cost centre managers are required to analyze significant variances between actual and budgeted labour expenses. Should a significant amount be inappropriately recorded, it would be identified through this process.

We have prepared the reconciliation for 2010 and, given the above noted controls, agree to review the frequency with which we reconcile the reported wages, salaries and benefits expense to the payroll register to ensure expenses are properly classified.

### **1.3 Schedules supporting the TTC's capital asset balances, including additions, disposals, depreciation calculations and capital subsidies should be automated.**

#### **Observation**

During our testing of capital assets, it was noted that the capital asset process is not automated. Rather, excel spreadsheets are used to track and account for expenditures on capital asset, asset disposals, capital subsidies received, depreciation of capital assets and the amortization of capital subsidies.

#### **Implication**

The use of excel spreadsheets to track and account for such significant balances is less secure, more time intensive and increases the risk of error.

#### **Recommendation**

Management should investigate capital asset software packages to automate their capital asset continuity schedules. Doing so may allow the TTC to:

- More accurately track capital spending against associated capital subsidies
- Reduce the amount of estimation used in determining depreciation expense and capital subsidy amortization throughout year.

In the interim, we recommend that management implement spreadsheet controls around the current excel spreadsheets being used, restricting access though password controls and write-protecting the continuity schedules so that changes cannot be made inadvertently or without appropriate authorization or approval.

#### **Management Response**

Improvements to the automation of the capture of capital asset information are in the process of being made. We agree that there is value in capturing this information in an asset tracking system which will maintain an increased granularity of capital addition information and enable improved reporting for management and financial purposes.

The Capital Asset system in the Worth-It software application has been established for 2006 assets of record and subsequent year capital additions (for years 2007-2010) are in the process of being finalized. This system has password protection and security features which controls access and updates to the information. This system implementation will be completed in 2011 and will require some realignment of asset groupings on the balance sheet, establishment of reporting and consideration of PSAB requirements. The tracking of capital expenditures, funding and related capital additions will continue to be handled through spreadsheets under the direct control of Capital Accounting staff. These spreadsheets are required to handle the detailed tracking of project expenditure reporting from the legacy financial systems and consolidate that information with the actual funding allocation by project. These will also track the capitalization decisions on each project's work in

process balance and current year expenditures. Some spreadsheets, including depreciation tracking, will no longer be required upon the full implementation of this system.

Most of the TTC Capital expenditures and assets do not involve discrete locations for which information is available at a granular level, and the nature of capital costs involves multiple cost sources which require allocations of costs. Although there are elements of TTC Capital Assets that are quite trackable (such as revenue & non-revenue vehicles and shop equipment), much of the capital infrastructure of the TTC system is not trackable for financial asset tracking. However, there are various user systems which capture very detailed tracking of system elements for operational control and condition assessment purposes at the department level.

We are not aware that there were any spreadsheet errors or uncontrolled/unauthorized changes to the spreadsheets that presented any problems that were raised during the audit; however increased controls in spreadsheets will be incorporated (including password protection for changes to key fields) for spreadsheets which are utilized for user input and update.

## **2. Toronto Transit Commission Insurance Company (TTCIC)**

### **2.1 Lack of restricted access to reserve amounts within Riskmaster**

#### **Observation**

During our audit procedures, it was noted that nine no-fault adjusters can make changes to reserve amounts on open claims within Riskmaster.

#### **Implication**

Riskmaster will not allow for a claim to be paid unless an equivalent reserve has been set up in the system. Therefore, there is an increased risk that claim payments could be made in excess of an adjuster's limit because s/he has access to change the reserve amount,

#### **Recommendation**

The ability to increase a reserve in Riskmaster in excess of an adjustor's limit should be restricted to data entry clerks and should require prior approval from the respective adjustor's supervisor.

Alternatively, authority limits should be set within Riskmaster to prevent an adjustor from setting a reserve above their assigned limit. If a reserve or change in reserve is required above an adjuster's assigned limit then that change should require secondary approval by a supervisor.

#### **Management Response**

Currently there are nine no fault adjusters within the Claims Department who have change access to reserve amounts and these adjusters each have a specific reserving dollar authority up to \$100,000. Should the adjuster require additional reserving authority over their limit, they are required to complete a Reserve Summary Form and obtain written approval from their supervisor up to a limit of \$250,000. If additional reserving authority is required over \$250,000 then the supervisor requires written approval from the Director up to \$500,000. Any dollar authority needed over \$500,000 on any one claimant requires written approval from the General Counsel. In addition to the above, quarterly reserving reports are generated on each open claimant and these are reviewed by Claims Management Staff. The quarterly reserve report lists the original reserve for each claim, the current reserve and what has been paid for each claim. Supervisory staff select files for detail review based on this report.

In addition to the controls already in place, management will investigate a method of implementing authority levels within Riskmaster (such as code or personal requirements) to eliminate the need for written authority on each file.

## **2.2 Claim payments**

### **Observation**

In auditing the claim payment process it was noted that adjusters have the ability to make claim payments within an authority limit while visiting a claimant off-site. Adjusters are permitted to make payments above their authority limit with prior approval from their supervisor.

### **Implication**

There is some risk of an unauthorized payment given that there is no IT system to prevent the release of a bank draft that has been written in excess of an adjuster's limit without the supervisor approval.

### **Recommendation**

The payment process should be automated through the Riskmaster system with automated authority limits. Should a claim payment be above an adjuster's authority limit the system should hold the payment until the supervisor approves the payment.

### **Management Response**

Currently all adjusters have the authority to write a draft within their individual dollar authority. All adjusters are fully aware that any draft written above their authority without prior approval could lead to disciplinary action up to and including dismissal.

All payments are bank drafts (not cash) and whether the draft is issued in or outside the office, it is processed in the same fashion. All drafts are sequentially numbered when assigned to the adjuster and they are required to verify and sign for the drafts they have been issued.

Once the draft is issued by the adjuster to the claimant and processed through Riskmaster the payment is entered on to a transmittal sheet by Claims department clerical staff. The transmittal sheet lists the draft number and the amount of the draft. The Claims Director reviews the transmittal sheet and the draft copies to ensure that all payments listed are within adjuster's limit. If the amount of the payment exceeds the adjuster's authority, the draft copy would have the supervisor's sign-off, which is verified by the Claims Director. Once this verification has been completed, the payment information is forwarded to Finance. Finance staff reconcile payments processed through the bank, with this record of authorized payments listed in Riskmaster. If Finance staff identify a payment that was not listed in Riskmaster, Claims staff would be immediately contacted to follow-up.

All claimants assigned to an adjuster are done so by Claims Management Staff who have reviewed the reports and confirm the incident. The adjusters have no prior knowledge as to which claimant they are going to be assigned.

In addition to the controls already in place, Claims staff are in the process of reviewing if certain recurring payments (e.g. weekly benefits) can be processed automatically through Riskmaster.

### **3. IT Control Recommendations**

#### **3.1 Password security parameters**

##### **Observation**

Password security parameters are not configured in an effective manner for mainframe applications or MMS (purchases and payables) and VSAM databases (general ledger /payroll).

##### **Implication**

With current password security parameters, logical access controls may not be strong enough to prevent unauthorized access to programs and data. Consequently, users are able to setup easily guessable passwords (non alpha-numeric). In addition, MMS (purchases and payables) and VSAM databases (general ledger /payroll) users are able to re-enter their passwords an unlimited number of times without being locked out.

##### **Recommendation**

Management should consider strengthening password controls by strengthening the password requirements, such as enforcing a password history, so that the last five passwords are remembered and cannot be reused and passwords should expire every 90 days. In addition, passwords should be alpha-numeric and should be a minimum password length of six to eight characters. The system should also lock users out after three invalid login attempts.

##### **Management Response**

The recommendations submitted above cannot be applied to those mainframe applications in scope due to their design and capabilities for passwords. However, before any users can log into a mainframe application they are required to have the following:

- i) Network user ID and password (password policy, which complies with the recommendations above is in force.)
- ii) Mainframe user ID and password (password policy which complies with the recommendations above is in force.)
- iii) The application user ID and password required.

The TTC password policy is based on industry standards for strong passwords, limited reuse of passwords and timed locking of workstations in a controlled active directory environment which complies with the recommendations.

The MMS IDMS database does not have the capability to enforce passwords rules such as those identified by the recommendations above due to the design and there is no capability to include them. However a userid and password is required at this 3<sup>rd</sup> level of application access.

The MMS database is scheduled to be replaced by IFS on May 11, 2011. The new IFS system will be able to enforce the TTC password policy.

The VSAM database access is restricted to mainframe users only. A user must have a network, Mainframe and application ID and password, to be granted access to the files. The file structure does not lend itself to text viewing.

In addition to the above, management will review the remaining legacy systems and where possible, make changes, to ensure that these application are in line with the TTC password policy.

### **3.2 Development and testing environments not effectively segregated**

#### **Observation**

Currently, development and testing environments are not segregated for the TTC's purchases and payables system (MMS).

In addition, there is no system restriction to prevent developers from migrating changes to the production environment for the following applications (MMS, Finance and Payroll).

#### **Implication**

Unauthorized program changes could be made that may result in the misstatement of financial data. Changes may be developed and/or tested in the wrong environment.

#### **Recommendation**

Management should consider segregating the development and testing environments for MMS and access to make changes in the production environment should be restricted to only developers.

#### **Management Response**

Unauthorized programs changes are unlikely to happen because developers responsible for the applications in scope do not have access to production.

Although the physical environments for development and testing are not separated, usage must be scheduled by the group using it.

The content of the environment being used is wiped clean and populated appropriately for the using group. Hence, an environment to be used for testing will contain only the data and user-ids for that group.

Source code changes initiated by developers are implemented by the Operations Support group.

The IT department has a prescribed standard change process which includes an audit trail for all changes defined in the standard change process and requires user approval before any scheduled implementation is made to the production environment.

### **3.3 Super-user/administrative application transactions are not monitored**

#### **Observation**

Super-user and administrative application transactions are not monitored. No audit log is enabled at the application level.

#### **Implication**

Unauthorized changes made in the production environment by privileged users would be difficult to detect.

#### **Recommendation**

Management may consider reviewing a log of super-user and administrative application transactions on a periodic basis.

#### **Management Response**

There are a limited number of TTC employees with super-user and/or administrative access rights.

Not all systems have the ability to log all transactions. The payroll system has an explicit audit trail available. A transaction history file in the payroll application keeps track of all employee information updates.

A review will be completed to identify systems where logging is technically possible. In addition, a review will be conducted of access requirements of support personnel.

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