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City of Toronto

2012 Year-end report to the Audit Committee

Prepared as of June 19, 2013

pwc

June 19, 2013

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

Dear Members of the Audit Committee:

PricewaterhouseCoopers LLP (PwC or we) has substantially completed our audit of the consolidated financial statements of City of Toronto (the City) prepared in accordance with Canadian generally accepted accounting principles (Public Sector GAAP) for the year ended December 31, 2012. We propose to issue an unqualified report on those financial statements, pending resolution of 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 financial statements. It includes an update on the status of our work, as well as a discussion on 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 on July 4, 2013 and discuss with you our key findings.

We would like to express our sincere thanks to the management and the staff of the City who have assisted us in carrying out our work. 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. R. Rossini, Deputy City Manager & Chief Financial Officer
Mr. J. Griffiths, Auditor General

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Appendices

1. Executive summary

a. Status of the audit

We have substantially completed our audit of the 2012 City of Toronto consolidated financial statements (the financial statements). Our auditor's report will be issued once we receive and have completed our audit work on the outstanding items noted below.

This document includes the required communications between an auditor and Audit Committee, as required by Canadian generally accepted auditing standards (Canadian GAAS).

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 item	
i.	Responses to our legal confirmation letters from external legal counsel
ii.	Finalization of certain minor audit procedures related to the review of the note disclosures in the consolidated financial statements
iii.	Completion of subsequent events procedures to the date of our audit opinion
iv.	Receipt of signed management representation letter
v.	Approval of the financial statements by the City Council

b. Key issues for discussion

Discussion item	Summary	For further reference
Significant audit, accounting and financial reporting matters	• During our audit we discussed the following items with management: i) Adjustment relating to Toronto Waterfront Revitalization Corporation ii) Adjustment to deferred revenue iii) Disposal of Union Station West Wing iv) Sale of investment in Enwave Energy Corporation v) Revenue recognition vi) Accounting for employee future benefit liabilities vii) Other significant accounting estimates viii) Consolidation process ix) Management override of controls	Section 2

Discussion item	Summary	For further reference
Summary of unadjusted items	• As a result of our audit, we identified unadjusted items with an annual surplus effect of $14.8 million understatement of annual surplus for the year ended December 31, 2012 and adjusted differences totalling $91.7 million (increase of annual surplus) • Unadjusted and adjusted items, can be found in Appendix B • In our opinion, the financial statements, taken as a whole, are free of material misstatement	Appendix B
Fraud	• No instances of fraud were noted as part of our audit procedures • We wish to reconfirm whether the Audit Committee is aware of any known, suspected or alleged incidents of fraud	
Management representations	• Under Canadian GAAS, 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 C	Appendix C
Independence	• We confirm that we are independent of the City as at June 19, 2013 and our independence letter can be found in Appendix D	Appendix D
Internal control deficiencies	• While completing our audit procedures we identified certain internal control recommendations for management's consideration which are itemized in Appendix E	Appendix E

2. Significant audit, accounting and financial reporting matters

Preparation of the financial statements requires management to select accounting policies, as well as make critical accounting estimates and disclosures that may involve significant judgment and measurement uncertainty. These matters 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 accounting policies, the accounting estimates, and financial statement disclosures in accordance with the requirements of Public Sector GAAP.

Our comments and views included in this report should only be taken in the context of the financial statements as a whole and are not meant to express an opinion on any individual item or accounting estimate. We are sharing our views with you to facilitate an open dialogue of these matters.

Year-end matters

Item #1	**Adjustment relating to Toronto Waterfront Revitalization Corporation**
Background information and management's process	In their most recent financial statements, an entity jointly controlled by the City, Toronto Waterfront Revitalization Corporation (TWRC), restated their statement of financial position to capitalize costs incurred relating to assets under development, previously these costs were expensed by TWRC. The City proportionately consolidates 1/3 of TWRC. The 2011 financial statement balances have been restated and Note 2 to the financial statements provides a description of the impact of the restatement to previously reported balances, including tangible capital assets, planning and development expenses and accumulated surplus. The impact on the 2011 opening accumulated surplus is an increase of $40.3 million and a decrease in planning and development expenses for the 2011 period of $29.8 million.
PwC's views	We have reviewed the accounting implications of the items discussed above. We have received TWRC auditor's report to the finance committee of TWRC as well as the draft financial statements, which are scheduled to be approved on June 26, 2013. We have reviewed the financial statement disclosures and found them to be accurate and complete. In addition to the above adjustment, during 2011, a piece of developed land was transferred from TWRC to the City. The net impact of this transfer was recorded in 2012 as a gain for the City. This gain has been recorded in the incorrect period as it should have been recorded in 2011 and as a result we have included an out of period adjustment for $22.7 million in the summary of unadjusted items (Appendix B).

Item #2	**Adjustment to deferred revenue**
Background information and management's process	During the year, a review of deferred revenue accounts was undertaken and as a result management determined that certain credits were incorrectly recorded in deferred revenue. These credits related to loans that were issued years ago to entities not controlled by the City from the reserve and reserve fund and have been shown in the City's consolidated financial statements as both loans receivable and deferred revenue. Management was essentially expensing the loans on issuance and revenue was recognized upon repayment of the loans. Upon investigation, management has concluded it is not appropriate to expense the loans to the statement of operations unless loans are determined to be uncollectable or the loans are expected to be forgiven. In order to ensure that all deferred revenue loan balances are properly corrected, adjustments are required to the 2012 financial statements. Management has restated the 2011 opening balances and 2011 comparatives. The effect of this restatement results in an increase of the 2011 opening accumulated surplus of $57.6 million and an increase to the 2011 annual surplus as a reduction of expenses of $1.6 million.
PwC's views	We gained an understanding of the process surrounding the determination of what deferred revenue accounts represented loans issued from the City's reserve and reserve fund and were incorrectly recorded in deferred revenue. We performed various audit procedures, including substantive test of details over the adjustment as well as test of details over the remaining deferred revenue balance to ensure completeness of the adjustment. We agree with management's assessment and adjustment made. Also, upon testing of the remaining deferred revenue balances we did not find any additional deferred revenue items that should be adjusted and therefore conclude that the remaining balance included in deferred revenue is appropriate.

Item #3	**Disposal of Union Station West Wing**
Background information and management's process	In 2008 the City entered into a series of agreements with MetroLinx whereby MetroLinx has agreed to purchase the property and assets related to certain areas of Union Station and the development thereof. During 2012, the first contract in this arrangement was completed and the refurbished assets were transferred from the City to MetroLinx. Completion of the first contract, the West Wing, resulted in net proceeds received in excess of total costs and as a result, a gain was recognized in the current period.
PwC's views	We have reviewed management's accounting policy and the application of this policy to the agreements entered into with MetroLinx. We have detail tested the calculation and noted adjustments which were required to ensure all revenue, expenses and receivables were appropriately recognized. Adjustments were recorded to increase revenue recognized by $41.1 million, increase expenses by $21.5 million, decrease inventory by $15.1 million and decrease deferred revenue by $21.9 million. These amounts have been included in Appendix B, the listing of adjusted items.

Item #4	**Sale of investment in Enwave Energy Corporation**
Background information and management's process	In October 2012 City Council adopted the recommendation from the Deputy City Manager and Chief Financial Officer to divest the City's 43% interest in Enwave Energy Corporation (Enwave). Enwave was previously accounted for as a government business enterprise, using the modified equity method of accounting as the Corporation can in its normal course of operations, maintain its operations and meet its liabilities from revenue received from sources outside of the City of Toronto. Under Public Sector GAAP, when all of a government's investment in a government business enterprise is sold, the gain or loss on the sale should be included in the determination of the consolidated operating results in the period of the sale. On the date the sale was finalized, the net proceeds received were greater than the carrying value of Enwave and a gain of $97 million was recorded in the consolidated statement of operations.
PwC's views	We have reviewed management's calculation of the net proceeds received and carrying value of the asset at the date of sale and found them to be reasonable and supportable. We have inspected the terms of the executed purchase price agreement and have recalculated the gain recorded by the City in their consolidated statement of operations. No issues were identified.

Update to audit risks noted in our planning report to the audit committee

Revenue Recognition	We have completed the planned procedures and as a result of our audit testing we noted a $10.5 million out of period adjustment. Management identified an error in the population of data used to estimate water usage revenue at year-end and as a result of a true-up of prior year amounts was recorded in the current year. This gives rise to an out of period adjustment for revenues recognized in 2012 relating to prior periods.
Employee benefits – Pension and other non-pension benefit plans	We have performed the procedures as noted in our audit plan and as a result, it was discovered that the participant data provided to the actuary did not represent the most accurate data as of December 31, 2012. Consequently, the employee benefit liability was overstated by an amount up to $15 million. This adjustment is reported on our summary of uncorrected misstatements in Appendix B and an internal control recommendation has been communicated to management in Appendix E.
Other significant accounting estimates	**Provisions for assessment appeals on property taxes paid** The provision for property tax appeals is based on management's estimates of losses relating to successful appeals by taxpayers, using historical arbitration experience with consideration given to the age and nature of unsettled appeals. As at December 31, 2012, the City maintains a provision for property tax appeals of $389.6 million (2011 - $487.3 million). During 2012, a significant settlement was reached between the City and a group of property owners with respect to a dispute over property tax rates, resulting in an adjustment to the property tax provision rates on a go forward basis. The settlement had a significant impact on the provision in the current year as the change in estimate was appropriately reflected as a prospective adjustment.

	Landfill closure and post-closure liabilities At December 31, 2012, the City maintains a liability for closure/post-closure of $124.2 million. In our testing of estimated closure and post closure costs for active and inactive sites, we noted a computational error which resulted in an overstatement of the liability of $5.1 million. This amount has been adjusted by management and has been included in Appendix B.
Consolidation process	We have performed procedures as outlined in our audit plan and have identified several unadjusted and adjusted audit differences as a result of this testing. These adjustments relate to accounting framework differences between City and TCHC, elimination of interdivisional transactions and various reclasses and have all been reflected in Appendix B. In addition, consistent with prior year, we have raised an internal control recommendation relating to the financial statement close process for management's consideration, which has been included in our internal control letter provided in Appendix E of this report.
Management override of controls	Canadian GAAS 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. We have completed the planned procedures and have no matters to report.

3. Summary of unadjusted and adjusted items

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

Under Canadian GAAS, we are required to communicate to you the unadjusted items and the effect that they may have on our opinion and to request that unadjusted items be corrected. As a result of our audit, we identified certain items and have discussed these with management, and management adjusted the financial statements to reflect certain of these items. Management has concluded that the remaining unadjusted items, which are described in Appendix B, are immaterial individually and in the aggregate.

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

Adjustments made by the City as part of the audit process are 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 GAAS requires 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 you:

Matter to be communicated	PwC's response
Management's representations	• Under Canadian GAAS, 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 C
Significant deficiencies in internal control	• Recent changes to Canadian GAAS require us to communicate to the Audit Committee internal control weaknesses identified as part of our audit that are considered to be significant deficiencies • A significant deficiency is defined as an internal control deficiency that we consider merits the attention of the Audit Committee • See Appendix E of this report for our internal control recommendations that we would like to bring to the Audit Committee's attention
Other information in documents containing audited financial information	• There are no other documents that contain the audited financial statements
Significant difficulties or disagreements that occurred during the audit	• No difficulties or disagreements occurred while performing our audit that requires the attention of the Audit Committee
Fraud and illegal acts	• No fraud involving senior management, employees with a significant role in internal control or that would cause a material misstatement of the financial statements, came to our attention as a result of our audit procedures

5. Internal control recommendations

The purpose of our audit was to enable us to express an opinion on the financial statements. The audit included consideration of internal controls relevant to the preparation of the 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 internal control.

During our audit, we identified certain internal control recommendations that we have discussed with management that are designed to help the City improve its system of internal control and achieve operational efficiencies, and wish to bring these to your attention. These recommendations are outlined in a separate report to management, attached as Appendix E.

6. 2012 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 December 31, 2014.

In the current year we have incurred additional time during the audit as a result of performing additional procedures largely relating to accounting issues, specifically, the accounting for TWRC, the restatement to deferred revenue and calculation of accruals related to property tax and water usage. We have agreed to an additional bill amount of $30,000 with management.

Appendix A: Draft auditor's report

Independent Auditor’s Report

To the Members of Council, Inhabitants and Ratepayers of the of 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, 2012 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, which comprise 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 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, 2012 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.

DRAFT

Chartered Accountants, Licensed Public Accountants
Toronto, Canada
July 16, 2013

Appendix B: Summary of unadjusted and adjusted items

Summary of unadjusted and adjusted items

a. Unadjusted items

All amounts in $ million	Annual surplus	Statement of financial position		
Description	**Over (under) stated $**	**Assets (over) under stated $**	**Liabilities over (under) stated $**	**Opening accumulated surplus over (under) stated $**
Current year unadjusted differences				
1. To adjust for estimated impact of out of date census data used in calculating year-end employee benefit liability. Dr. Employee benefit liabilities Cr. Expenses	(15.0)		15.0	
2. Reclass within revenue line items related to the obligatory reserve fund. Dr. Development charge revenue Cr. Funding transfers from other government	50.0 (50.0)			
3. To reclass loans recorded within AR to other assets. Dr. Other assets Cr. AR		11.0 (11.0)		
4. To reverse impact of arising from differences in accounting frameworks between TCHC and the City relating to unamortized actuarial gains and losses. Dr. Employee benefit liabilities Dr. Opening accumulated surplus Cr. Expenses	(5.8)		0.5	5.3
Out of period adjustments				
5. Adjustment made in the current year to true-up deferred revenue based on 2011 final TCHC financial statements. Dr. Accumulated surplus Cr. Revenue	(12.5)			12.5

All amounts in $ million	Annual surplus	Statement of financial position		
Description	**Over (under) stated $**	**Assets (over) under stated $**	**Liabilities over (under) stated $**	**Opening accumulated surplus over (under) stated $**
6. Draft financial statement true-up relating to difference in final 2011 Build Toronto financial statements. Dr. Accumulated surplus Cr. Revenue	(14.7)			14.7
7. Out of period impact of recording gain in 2012 of TWRC transfer that occurred in 2011. Dr. Revenue Cr. Accumulated surplus	22.7			(22.7)
8. Out of period impact of change to water usage accrual estimation process. Dr. Revenue Cr. Opening accumulated surplus	10.5			(10.5)
Total unadjusted differences	**(14.8)**	**-**	**15.5**	**(0.7)**

As a result of our audit, we conclude that the above unadjusted items are individually and in the aggregate to the immaterial to the financial statements taken as a whole.

b. Adjusted items

All amounts in $ million	Annual surplus	Statement of financial position		
Description	Over (under) stated $	Assets (over) under stated $	Liabilities over (under) stated $	Opening accumulated surplus over (under) stated $
Current year adjusted differences				
1. To recognize revenue and costs related to the completion of the west wing of the Union Station project. Dr. Expenses Dr. Deferred revenues Dr. Accounts receivable Cr. Tangible capital assets Cr. Inventory Cr. Other income	21.5 (41.1)	 4.1 (6.4) (15.1)	 37	
2. To adjust for computational error within the landfill obligation calculation. Dr. Landfill closure and post-closure liabilities Cr. Expenses	(5.1)		5.1	
3. Reclassification of credit balances in accounts receivable to accounts payable. Dr. AP & accrued liabilities Cr. AR		(8.6)	8.6	
4. To correct entry made to reverse tax revenue. Dr. AP & accrued liabilities Cr. AR		(10.2)	10.2	
5. To offset waste disposal costs recognized by the City with waste disposal revenue recognized by Green Lane. Dr. Other revenue Cr. Contracted services	36.0 (36.0)			
6. To reclassify expenses as reported by Exhibition Place. Dr. Materials expense Cr. Salaries & benefit expense	27.0 (27.0)			
7. To reclassify child care subsidy amounts. Dr. User charge revenue Cr. Transfer payment expense	17.8 (17.8)			

All amounts in $ million	Annual surplus	Statement of financial position		
Description	Over (under) stated $	Assets (over) under stated $	Liabilities over (under) stated $	Opening accumulated surplus over (under) stated $
8. To adjust for credits in accounts receivable that relate to overpayments made to the City as prepaid assets and liabilities (advances). Dr. Prepaid expenses Cr. AP and accrued liabilities		26.7	(26.7)	
9. To adjust the consolidation entry for TTC construction holdbacks. Dr. Accounts Receivable Cr. Operating expenses	(67.0)	67.0		
10. To reclass cash and cash equivalents in the consolidation of Toronto Public Library. Dr. Cash and cash equivalents Cr. Accounts receivable		20.0 (20.0)		
Total adjusted differences	**(91.7)**	**57.5**	**34.2**	**-**

Appendix C: Management representation letter

[To be printed on letterhead]

July 16, 2012

Ms. Cathy Russell, Partner
PricewaterhouseCoopers LLP
PwC Tower
18 York Street, Suite 2600
Toronto ON M5J 0B2

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, 2012 and for the year then ended (the financial statements) for the purpose of expressing an opinion as to whether such financial statements present fairly, in all material respects, the financial position, the results of operations, the changes in accumulated surplus and net debt and the cash flows in accordance with Canadian public sector accounting standards.

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 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 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 financial statements.

We confirm the following representations:

Preparation of financial statements
The 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 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 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 financial statements.

Accounting policies
We confirm that we have reviewed our 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 financial statements is appropriate in our 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.

Internal controls over financial reporting
We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to us, including our 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, 2012.

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 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 March 20, 2013 and Audit Committee on February 15, 2013
- Additional information that you have requested from us for the purpose of the audit
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence

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

Fraud
We have disclosed to you:

- the results of our assessment of the risk that the 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 us involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements; and

- all information in relation to any allegations of fraud, or suspected fraud, affecting the financial statements, communicated by employees, former employees, analysts, regulators or others.

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

We are not aware of any illegal or possibly illegal acts committed by our directors, officers or employees acting on our behalf.

Accounting estimates and fair value measurements
Significant assumptions used by us in making accounting estimates, including fair value accounting estimates, are reasonable.

For recorded or disclosed amounts in the 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 financial statements; and
- the significant assumptions used in determining fair value measurements are consistent with our 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.

Related party transactions
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 our 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 financial statements, as required by Canadian public sector accounting standards.

The list of related parties as detailed in note 6 of the City financial statements accurately and completely describes the City related parties and the relationships with such parties.

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

Assets and liabilities
We have satisfactory title or control over all assets. There are no liens or encumbrances on our assets and no assets 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, whether written or oral, under which we are contingently liable in accordance with the CICA Public Sector Accounting Handbook Section PS 3300, Contingent Liabilities, have been disclosed to you and are appropriately reflected in the financial statements.

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.

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 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 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 B of your audit committee report have been approved by us and adjusted in the financial statements.

Restatement of prior period's balances
The restatement made to correct a material misstatement in the prior period's financial statements that affect the comparative information has been appropriately accounted for and disclosed in accordance with the requirements of Canadian public sector accounting standards.

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, 2012.

Restricted assets and revenues
All assets and revenue 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.

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. All receivables have been appropriately reduced to their estimated net realizable value.

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 CICA Public Sector Accounting Handbook PS 3050, Loans Receivable.

We have reviewed loans receivable for collectability, risk of loss and expected forgiveness, and made appropriate valuation allowances or write-offs thereon if necessary, in accordance with CICA Public Sector Accounting Handbook PS 3050, Loans Receivable. The valuation allowance for loan losses and/or forgiveness encompasses probable credit losses related to specifically identified loans as well as probable credit losses inherent in the remainder of the loan portfolio that have been incurred as at December 31, 2012.

Inventory
Provision has been made to reduce excess or obsolete inventories held for re-sale to their estimated net realizable value.

There have been no events conditions or changes in circumstances that indicate inventory held for consumption will no longer be used or consumed in the City's operations.

Financial assets
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.

Enwave Energy Corporation (divested October 31, 2012), Toronto Hydro Corporation, Toronto Ports Land Corporation and Toronto Parking Authority meet the definition of a government business enterprise (GBE) in accordance with PS 3070*, Investments in Government Enterprises*.

The modified equity method is used to account for the City's investment in these government business enterprises.

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.

There are no indicators of impairment to tangible capital assets at December 31, 2012. As such, we did not perform testing to ensure recoverability of tangible capital assets and no impairment exists.

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 CICA Public Sector Accounting Handbook PS 3150.

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, 2012, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

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

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, 2012, the date of the last actuarial valuation, have been identified to you.
The actuarial valuation dated December 31, 2012 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, 2012 and where applicable, their extrapolation to December 31, 2012.

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 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 Buck, Morneau Shepell and Oliver Wyman 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 Public Sector Accounting Handbook Section 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.

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).

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.

Use of a specialist
We assume responsibility for the findings of 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.

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.

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.

Segment disclosures
Pursuant to CICA Public Sector Accounting Handbook PS 2700, Segment Disclosures, in identifying segments, management has considered the definition of a segment and other factors, including:

- the objectives of disclosing financial information by segment;
- the expectations of members of the community and their elected or appointed representatives regarding the key activities and accountabilities of the government;
- the qualitative characteristics of financial reporting as set out in CICA Public Sector Accounting Handbook PS 1000, Financial Statement Concepts;

- the homogeneous nature of the activities, service delivery, or recipients of the services;
- whether the activities relate to the achievement of common outcomes or services as reflected in government performance reports and plans;
- whether discrete financial information is reported or available; and
- 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, Environment services, Health services, Social and family services, Social Housing, Recreation 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.

Government transfers
Transferring organization
Transfers have only been recognized as an expense in the period the transfer has been authorized and all eligibility criteria have been met by the recipient.

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

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 CICA Public Sector Accounting Handbook 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.

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

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

Mr. J. Pennachetti, City Manager

Mr. R. Rossini, Deputy City Manager & Chief Financial Officer

Ms. G. Carbone, Treasurer

Mr. M. St.Amant, Director Accounting Services

Appendix D: Independence letter

June 19, 2013

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 City of Toronto (the City) for the year ended December 31, 2012.

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 June 18, 2012 to June 19, 2013.

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 19, 2013.

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 purpose.

PricewaterhouseCoopers LLP
PwC Tower, 18 York Street, Suite 2600, Toronto, Ontario, Canada M5J 0B2
T: +1 416 863 1133, F: +1 416 365 8215, www.pwc.com/ca

We look forward to discussing with you the matters addressed in this letter at our upcoming meeting on July 4, 2013.

Yours very truly,

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Appendix E: Internal control recommendations

June 19, 2013

Mr. Roberto Rossini
Deputy City Manager and Chief Financial Officer
City of Toronto
Metro Hall – 55 John Street
Toronto, ON M5V 3C6

Management Letter
2012 Audit of City of Toronto

Dear Mr. Rossini:

We have substantially completed our audit examination of the consolidated financial statements 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, 2012. 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.

PricewaterhouseCoopers LLP
PwC Tower, 18 York Street, Suite 2600, Toronto, Ontario, Canada M5J 0B2
T: +1 416 863 1133, F: +1 416 365 8215, www.pwc.com/ca

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.

APPENDIX

Table of Contents

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

Internal control points identified in the prior year not yet fully addressed

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 the preparation of 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 and Corporations (A&C's) that are consolidated within its financial statements. In addition, some of the A&C's follow different accounting frameworks than the City and their financial results need to be adjusted to conform to the City's accounting standards. Further, since the A&C'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 FSCP, we noted a significant number of adjustments recorded on consolidation relating to intercompany eliminations, reclassifications, adjustments to the accounting records of the City's A&C's to conform with PSAS, 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 A&C'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 A&C's sufficiently in advance of the City's reporting deadlines, including the implementation of an accountability framework and enforcement by the City for all A&C's
- Timely communication by the A&C's to City management of any changes to their submitted financial statements
- City management provide the A&C's with a reconciliation schedule of the A&C's accounting standards to the City's accounting under PSAS
- Appropriate level of review of A&C 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 it's A&C's.

Management response:

2011:
Accounting staff have reviewed the types of software available, the benefits and the costs of implementation. As there was no capital budget allocated for this activity for the 2011 and 2012 budgets, Accounting staff are reviewing potential changes to the consolidation process that can be implemented using the current IT environment, as well as improvements which will be available in 2012 & 2013.

The enhanced process will then be reviewed against the incremental benefits and costs involved through implementing third-party software.

2012:
The City has taken a number of steps to improve the timeliness of and detail received from A&Cs, with substantial improvements noted for the 2012 financial statements. During the summer of 2013 Accounting staff will communicate all financial statement changes with agencies and corporations for 2012 and include additional information requirements regarding these reconciliations in the year end instructions for 2013.

Accounting staff has also continued and will continue in 2013 to make incremental improvements to the consolidation process to provide clarity of transactions and make the whole process more transparent. Once the new IT environment is in place and functioning in 2014, the process will be re-designed for the 2014 consolidated statements.

1.2 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 assets held by the City 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 in amortized cost with consideration given to the different methodologies between the City and the trustee.

Management response:

2011:
Corporate Finance and Accounting staff will investigate the possibilities of aligning the accounting methodologies for cost and amortization used by the Custodian and the City.

In the event that the alignment of accounting methodologies with the Custodian is not cost-effective, Corporate Finance and Accounting Services staff will undertake to provide reconciliation having regard to segregation of duties principles.

2012:
In 2012 staff met with RBC Investor Services, who are not able to adopt the City's costing methodology. Although a full reconciliation of securities par values and market values was performed at year end, Accounting Services will review RBC costing methodologies and also include a reconciliation of City cost to RBC book values for 2013.

1.3 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 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 this expense and liability balances.

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 and assumptions.

Management response:

2011:
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.

2012:
An experience study has been requested as part of the new contract with Buck Consultants. The experience study will be completed during the third quarter of 2013.

Internal control points identified during the 2012 audit

1.4 Review of bank reconciliations

Observation:

In our testing of cash balances at year-end we noted certain bank reconciliations were not reviewed and approved in a timely manner. In addition, during testing it was noted there were various discrepancies, unreconciled items and mathematical errors within the reconciliations.

Impact:

There is an increased risk of misstatement of the cash balance and misappropriation of City funds due to errors, discrepancies and lack of timely review over bank reconciliations.

Recommendation:

Management should perform a thorough and timely review of all bank reconciliations to ensure that discrepancies and errors are corrected in a timely manner.

Management response:

Accounting Services has been working with Global Payments and Divisions to ensure that timely reporting is available to properly reconcile point-of-sale items. Accounting Services will continue to receive reporting on completion of reconciliations throughout the year from each responsible Division, and will ensure timely follow up and completion of outstanding issues.

1.5 Accuracy of census data provided to the actuaries

Observation:

During our testing of the City's employee benefits at year-end we noted that the membership data relied upon by the Actuary for the City's five defined benefit pension plans was extracted as of October 31, 2012, instead of December 31, 2012.

Impact:

The Actuary relies on the accuracy and completeness of the data provided by the City. The actuarial analysis is based on the underlining demographics of the members and as such, the membership data provided by the City plays an important role. If the underlying data is inaccurate or incomplete, the results of the Actuary's analysis may be inaccurate or incomplete.

Recommendation:

In connection with the annual review of the assumptions to be used in the Actuary analysis, management should review the membership data provided to the Actuary to ensure the data is accurate, complete, and extracted as of the valuation date.

Management response:

Staff will review the membership data utilized by the Actuary for the preparation of the Valuation Report to ensure it is accurate, complete and reflective of the membership as of the valuation date.

1.6 Completeness of journal entries

Observation:

In our testing of inventory balances at year-end we noted a division of Union Station was sold to a third party in 2012; however no accounting entry was made to reflect this sale in the accounting records. In addition, it was noted that certain transactions between the City and related entities were not appropriately identified and/or recorded in the accounting records. As a result, a transfer of property from a related entity to the City was not reflected in the appropriate period.

Impact:

The City's asset balance may be inaccurate if all purchase and disposal transactions are not appropriately recognized in the accounting records. Also, the City may not appropriately identify the accounting implications of one-off transactions, such as recognizing a gain/loss on transfer of assets or the transaction may not be included in the appropriate period.

Recommendation:

Management should have a process to ensure completeness of journal entries for significant acquisitions, transfers and disposals. Implementation of a formal period-end close checklist may assist in ensuring all accounting implications of a transaction have been considered and recorded.

Management response:

All significant transactions disposing of sections of Union Station will be reviewed with project management, documented each year end and approved by the Director of Accounting Services as part of the year end process. In addition, cut-off procedures at the City will be enhanced to ensure that any transactions from related parties, in particular TWRC, are reviewed and properly accounted for.

1.7 Completeness and accuracy of underlying data used for accrual analysis

Observation:

During our testing over the water revenue accrual and the provision for pending property tax appeals, we noted exceptions in the completeness and accuracy of underlying data. These exceptions were driven by flaws in the automated search and retrieve codes used to compile the relevant underlying data over which the analysis is performed to develop an appropriate accrual/provision estimate. These process flaws are not consistently identified with adequate time to react and revise accrual balances to reflect management's best estimate in the accurate accounting period.

Impact:

Unreliable processes in compiling data results in accruals developed from incomplete and/or unrepresentative information. The underlying data drives the analysis and assumptions used to develop significant accruals, thus exposing the balance to increased risk of misstatement if that data is not reliable. This can in-turn result in required adjustments to accruals these issues are identified, and generally less confidence in the “best-estimates” made by management.

Recommendation:

Management should strengthen the detail and depth of the review procedures in place over the process of developing the accruals, with specific consideration of the IT program-related dependencies. We recommend the integrated involvement of both IT personnel and finance personnel when developing and reviewing these processes to ensure that preventative controls are built into the processes, but also that detective controls exist which can identify these weaknesses more efficiently. A more comprehensive review will not only ensure that the overall balance is reasonable, but also that the process in developing that accrual is sound.

Management response:

During the year, items which contained a "Null" field were excluded in the data extracted for two accruals. Revenue Services and IT staff have reviewed the problem and will ensure that in future extracts, all data will be included, regardless of whether a particular data element was populated or not.

2. City of Toronto (information technology internal control related recommendations)

Internal control points identified in the prior year not yet addressed

2.1 Periodic user access rights review

Observation:

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

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:

2011
Facilities management (facilities services)

Acknowledged. FMD has been working with business and technical teams to implement new technology, and a corresponding new process to enable business unit managers to efficiently and effectively review SAP access for those areas which they approve access for. A new process was drafted in May of 2011, and presented to and signed off by business unit managers on June 13, 2011. There have been some delays in on the technical side, but the custom report development is now substantially completed. In addition to a regular review process (currently planned to be monthly, and not less than quarterly), there will also be a one-time review of user access by Business Unit approvers to ensure any previously assigned access is still appropriate, after which the monthly process will catch and report any changes. The new report and process will be active and implemented in production by Q3-2012.

I&T (solutions development & sustainment)
The SAP Landscape Upgrade Project developed an SAP security strategy in 2011 that includes a leading practice of position-based security roles. This strategy will be implemented as part of the Public Budget Formulation (PBF) Implementation Project in 2013 and so that SAP security is aligned with the job responsibilities in that position.

2012:
FASP

In 2012 FASP conducted seven reviews where lists of user access where sent to the Divisions to validate. For 2013, FASP will send regular lists to selected Divisions for confirmation of access. Access to critical transactions not required will be removed as soon as possible.

Human resources (HR)

HR conducted a review of user access rights for Toronto Water in 2012. For 2013, HR plans to review all complement management users and the structural authorization they have.

I&T

Access to deleting and analyzing security logs will be removed from the individual BASIS team members by the end of Q3 2013. Critical transactions required by the Security team will be moved to a new role (extended security role) that is intended for use by the emergency user only in the productive environment. This change will be done by the end of Q3 2013. Access to critical transactions not required will be removed by the end of Q3 2013.

2.2 Timely inactivation of terminated employee accounts

Observation:

PwC noted approximately twenty users who were not deactivated for a significant number of days after the termination date. Of these users there were only two exceptions whereby the user accessed the system post the termination date. Upon further investigation, there were reasonable explanations as to why the users accessed the system, however to avoid exposure to potential access after termination, the City should deactivate terminated users on a timely basis.

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 a review of 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. Best industry practice is for the user account to be disabled at day of departure. The removal of all access rights should be confirmed by administrators as part of employee exit procedures.

Management response:

2011 & 2012
Pension, payroll & employee benefits

Pension, Payroll and Employee Benefits and Human Resources are currently reviewing the termination process, the Property Retrieval/Access Cancellation Checklist will be updated to include discontinuation of SAP access. Divisions will also be reminded to submit notification to discontinue access to SAP immediately upon receipt of termination notice.

Facilities management (facilities services)

The process for terminating users is the same for ALL SAP users across the City. The SAP user id is automatically deactivated by the end of business day after a personnel action is done in SAP indicating the termination of an employee. However, this process is reliant on timely submission of the Employee Separation Notice paperwork from the hiring manager, and timely processing of same by the Payroll staff.

I&T (solutions development & sustainment), finance, payroll and human resources

The ERP Competency Centre advises divisions on dormant user accounts but it is the division's responsibility to act on the dormant accounts.

Divisions make the decision whether it is operationally efficient to delete access or to otherwise limit access. These decisions will be approved and documented in each Division to support any accounts not deactivated.

2.3 SAP application payroll controls - segregation of duties

Observation:

SAP-enforced automated HR Infotype approval system is not implemented at City.

Impact:

The current access assigned 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
- *Effective March 2011*, City implemented a standard SAP system control to prevent users from updating their own Master Data record. The exception is a restricted number of Payroll Run users who process payroll runs and in critical situations may need to correct an entry to proceed with the pay run. Changes by these users will be monitored by a system generated report by other designated person(s). *This administrative process will be in place by Q2, 2012*

Recommendation:

During the year, payroll users who have access to change their own Master Data has been resolved with the implementation of the “Buddy System”. However, the risk that unauthorized changes are made to payroll data still exists and to further minimize the risk we would recommend that management implement a system control which restricts data access and changeability as well as implement a plan for monitoring payroll changes on a regular basis.

Management response:

2011
Pension, payroll & employee benefits

Management agrees with recommendation, periodic review and sign-off process in place effective April, 2012.

2012
A “Buddy System” is currently in place outside of SAP to address this. In addition, some very useful reports we run to supplement the "buddy system". Hours and Gross Pay Variance Report (it targets employees with differences between the standard hours/gross pay VS. the current pay run hour/gross). Net Pay variance - (it compares current pay to 2 prior pays for significant net pay differences -which will be checked by another supervisor/manager as well). Abnormal master data changes with financial impacts will also be picked up even if they slip through the buddy system.

During 2013, staff will investigate the feasibility of automating the second review.

2.4 SAP application – 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 a number of user accounts for operations support have access to transactions that provide conflicting abilities in the Financial Services division. For example access to maintain vendor master data and process invoices or access to create, change or release purchase orders and process and invoice for the same order.

Impact:

If proper segregation of duties does not exist, there is a risk that unauthorized processing could occur.

Recommendation:

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

Management response:

2011
Financial Accounting Systems & Policy (FASP)

Staff will review compensating controls with PwC audit staff in order to ensure that they are adequate.

2012:
Access for all Financial and Purchasing transactions is needed by the Senior Financial Analysts in Financial Accounting Systems & Policies who are 3rd level support for trouble shooting /resolving issues. They are not involved in posting any direct individual transactions for Accounts Payable, Accounts Receivable, General Ledger or Purchasing. This can be confirmed by the user IDs attached to such transactions. Exceptions are interfaces, mass reversals or postings associated with month/year end.

The Manager, FASP will run and review exception reports on a quarterly basis to identify any incompatible transactions run by the Senior Financial Analysts.

Internal control points identified during the 2012 audit

2.5 SAP ECC – changes are properly tested and approved prior to migration to production

Observation:

For 1 of out of 25 sampled changes, the developer and approval to production was performed by the same person.

Impact:

Unauthorized changes could be migrated to production.

Recommendation:

Segregation of duties should be implemented between the developer and approver to Production.

Management response:

HR's support team has 4 staff. One is for Change Advisory Board (CAB) member: this approver (Sr HR Consultant) must approve all Requests for Change in Solution Manager. The Solution Manager developer and the tester/approver are the same individual but the test documentation is attached to confirm the appropriate approved change has been made. In the Change Request Manager (ChaRM) in Solution Manager, the roles of requester, change manager, developer, tester, approver, etc. are assigned to the other 3 individuals. In addition each person is focused on entirely different modules of SAP, one for Organizational Management (OM), one for Training & Event Management (TEM) and one for Personnel Development & Qualifications (PDQ). All changes to Production are approved in Solution Manager by the CAB approver. Nothing can go to production with only one person working on and approving the change.

Appendix F: Recent developments in Public Sector Accounting

Recent developments in Public Sector Accounting

Upcoming changes to accounting standards

As part of our commitment to quality service, we now draw your attention to new and emerging accounting, auditing and regulatory developments together with their assessed impact on the City's financial reporting:

a. Government transfers

A revised Section PS 3410 was issued in February 2011 and is effective for fiscal years beginning on or after April 1, 2012. The new standard may be applied prospectively or retroactively. The objective of this project was to provide additional guidance and clarification to Section PS 3410, Government Transfers and to address application and interpretation issues raised by the government community.

An organization will need to consider the impact of the revised standard on:

- the appropriate accounting for multi-year funding provided by governments to outside organizations;
- when the transfer has been authorized;
- the degree to which stipulations imposed by a transferring government create a liability that must be recognized by the recipient government; and
- timing of revenue recognition for capital transfers.

Impact to the City: This standard is effective for the City for fiscal 2013. As previously communicated, 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. Liability for contaminated sites

Section PS 3260, Liability for Contaminated Sites is effective for periods beginning on or after April 1, 2014, although earlier adoption is encouraged. This standard provides specific guidance on how an organization accounts for a liability associated with the remediation of a contaminated site. It may be adopted prospectively or retroactively.

The main features are:

- A liability for remediation of a contaminated site is recognized when contamination exceeds an existing environmental standard, the organization is either directly responsible or accepts responsibility for the contamination, the organization expects that future economic benefits will be given up and can make a reasonable estimate of the amount of the liability.

- The liability is measured at the organization's best estimate of the amount required to remediate the contaminated site. When cash flows to settle the liability are expected to occur over several years then a discounted cash flow technique is usually the best method to estimate the liability.

- Enhanced disclosures over remediation liabilities are required.

Impact to the City: The City will need to consider the impact of these changes on their related entities, such as the TTC.

c. Financial instruments and financial statement presentation

Section PS 3450, Financial Instruments is already effective for government organizations (from April 1, 2012) and will be effective for governments for periods beginning on or after April 15, 2015. This section provides guidance on the recognition, measurement, presentation and disclosure of financial instruments. Derivatives and portfolio investments that are equity instruments quoted in an active market are measured at fair value. Other financial instruments may be elected as measured at fair value under certain conditions.

Concurrent with the adoption of Section PS 3450 organizations must adopt Section PS 1201, Financial Statement Presentation (replacing Section PS 1200) and Section PS 2601, Foreign Currency Translation (replacing PS 2600). These new standards require presentation of a new primary statement – the statement of remeasurement gains and losses – reporting various unrealized gains and losses and may also change the accounting for long-term foreign currency monetary items.

Impact to the City: The most significant impact to the City will be the presentation of the change in fair value of 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 fair value will now be recognized in the statement of re-measurement 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 re-measurement gains and losses.

d. Other projects

Other significant projects that are in progress by the Public Sector Accounting Board:

- **Related parties** – In September 2012, PSAB issued an exposure draft proposing a new PSA Handbook Section for Related Party Transactions. The exposure draft included guidance on the identification of related parties as well as the recognition and measurement of related party transactions. The Board has considered responses to the exposure draft and will be issuing a re-exposure draft with revised guidance to address concerns over key management personnel and measurement of related party transactions. The re-exposure draft is expected in June 2013 with a view to a final standard by the end of 2013. Our audit national public sector leader is the chair of the PSAB task force on this project.
- **Restructurings** – Restructurings may take many forms including amalgamations, transfers and reorganizations. This project aims to create a standard to define restructuring transactions and provide guidance on the recognition and measurement of assets and liabilities subject to restructuring as well as accounting for restructuring costs. A statement of principles was issued in February 2013, which proposes that restructurings involve the transfer of an integrated set of assets, liabilities and related responsibilities without the exchange of significant consideration based on the fair values of assets and liabilities transferred. Restructuring transactions are to be measured based on carrying values with limited adjustments. An exposure draft for a new standard is expected in early 2014.
- **Assets** – The objective of this project is to provide a standard that addresses the basic concepts and definition of assets, similar to the standard that already exists for liabilities (Section PS 3200). The first step in this project is a statement of principles that will define the essential characteristics of assets, 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 consider disclosure requirements. A draft statement of principles is expected in 2013.
- **Revenues** – This project is to develop additional principles for revenue recognition principles that apply to sources of revenue other than government transfers and tax revenue. It is a wide-reaching project seeking to address recognition, measurement and presentation of revenues that are common in the public sector. PSAB is currently working on a statement of principles, expected to be issued before the end of 2013.

- **Asset retirement obligations** – This project will introduce guidance on accounting for asset retirement obligations into the PSA Handbook. The project is in early stages with a statement of principles expected before the end of 2013. A partner from our National Office sits on the PSAB task force for this project.

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