TO: Chair and Members
Audit, Finance and Administration Committee

WARD(S) AFFECTED: CITY WIDE

COMMITTEE DATE: January 19, 2011

SUBJECT/REPORT NO:
Follow Up of Audit Report 2009-01 - Financial Requirements of Development (AUD11007) (City Wide)

SUBMITTED BY:
Ann Pekaruk
Director, Audit Services
City Manager's Office

PREPARED BY:
Ann Pekaruk 905-546-2424 x4469

RECOMMENDATION

That Report AUD11007 respecting the follow up of Audit Report 2009-01, Financial Requirements of Development, be received.

EXECUTIVE SUMMARY

Audit Report 2009-01, Financial Requirements of Developments, was originally issued May, 2009 and management action plans with implementation timelines were outlined in the Report. In October, 2010, Internal Audit conducted a follow up exercise to determine that appropriate and timely actions had been taken. Of the ten (10) recommendations made in the original Report, three (3) have been completed, three (3) have been initiated and four (4) have not been implemented.

*Alternatives for Consideration – Not Applicable*
FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: None.
Staffing: None.
Legal: None.

HISTORICAL BACKGROUND (Chronology of events)

Audit Report 2009-01, Financial Requirements of Development, was originally issued in May, 2009. The Report provided ten (10) recommendations identifying areas for improvement with respect to financial and administrative controls for the processing of security deposits.

It is normal practice for Internal Audit to conduct follow up reviews within a 12-18 month period following issuance of the original report in order to determine whether action plans committed to by department management have been implemented.

POLICY IMPLICATIONS

Planning Act (requirement to collect performance securities)

RELEVANT CONSULTATION

The results of the follow up were provided to the management and staff responsible for the financial and administrative controls of security deposits in Planning and Economic Development (Development Engineering) and Corporate Services (Budgets & Finance) Departments.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

The report attached as Appendix “A” to Report AUD11007 contains the first three columns as originally reported in Report 2009-01 along with an added fourth column indicating Internal Audit’s comments as a result of the follow up work.
Three (3) of the ten (10) recommendations have been fully implemented. These include: cheques are restrictively endorsed upon receipt, security deposits are no longer accepted by City inspection staff in the field and a comprehensive inventory of all Letters of Credit (LCs) has been developed.

Three (3) recommendations that have been initiated but with minimal progress include: determining the redundancy of any LCs no longer required by the City, reconciling LCs balances in the General Ledger to the register every quarter and reconciling the cash deposits sub-ledger to the General Ledger every quarter.

The four (4) recommendations that remain not completed are as follows: development of guidelines for interest payments of security deposits, adequate supporting documentation for and sign off on all interest payment deviations (as determined against guidelines) by the Manager of Capital Budgets and Development, confirmation of the validity of long outstanding LCs with financial institutions and the retention of supporting documentation for the quarterly LC reconciliations.

ALTERNATIVES FOR CONSIDERATION
(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

Not applicable.

CORPORATE STRATEGIC PLAN (Linkage to Desired End Results)


Financial Sustainability
• Delivery of municipal services and management of capital assets/liabilities in a sustainable, innovative and cost effective manner.
• Effective and sustainable Growth Management.

Healthy Community
• Plan and manage the built environment.

APPENDICES / SCHEDULES

Appendix “A” to Report AUD11007.

ap:tk
## Handling of Cheques

Cheques from developers in respect of security deposits for site plan, subdivision and consent agreements are received and kept by staff in several sections of the Planning and Economic Development Department. The cheques are neither logged nor restrictively endorsed upon initial receipt. Often, the cheques are kept overnight in staff's unlocked drawers, on desks or in exposed trays before being handed over to the Budgets and Finance Division for processing. Sometimes, staff even accept security deposits (i.e. cheques) from the developer in the field.

Given that some of the cheques handled are for large amounts, the risk of cheques being lost, stolen or fraudulently negotiated is increased when cheques are not restrictively endorsed, logged and tracked upon receipt. In 2008, for example, eight cheques of over $100,000 each accounted for 45% of the $3 million development related cash deposits received.

### Recommendation for Strengthening System

- That cheques be restrictively endorsed and logged upon initial receipt.
- That staff be directed not to accept developers’ security deposits in the field.

### Management Action Plan

- Agreed. Current Cash Handling Procedures will be adhered to. Staff in the tax receipt area and Planning and Economic Development Department have been instructed to keep a log identifying cheques received for development securities.
- Alternative to be implemented. The service of accepting security deposits in the field is provided as part of good business relations with the industry. This occasional practice will be reviewed and additional safeguards will be developed.

### Follow Up (October 2010)

- Completed. Development Financial Officers have maintained individual logs identifying cheques received for development securities since January 1, 2010.
- Completed. As of April 2009, City inspection staff were directed not to accept developers’ security deposits or other documents in the field.
## 2. Inconsistencies in the Payment of Interest

The City pays interest on development related deposits (except consent agreements) received by the City of Hamilton or the former Regional Municipality of Hamilton-Wentworth. Although there are guidelines that clearly state that interest is to be paid in such circumstances, the Development Financial Officer often exercises her own discretion regarding whether or not to pay interest on deposits. This results in some deposits being refunded without interest while others with the same circumstances receiving interest. The rationale for the Development Financial Officer’s decisions is often not documented or approved by a senior official.

While amounts are unlikely to be corporately significant given that large security deposits are often given in the form of letters of credit rather than cash deposits, there is a risk that the inconsistencies could create perceptions of preferential or unfair treatment.

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<th>OBSERVATION OF EXISTING SYSTEM</th>
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<th>MANAGEMENT ACTION PLAN</th>
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<td>The City pays interest on development related deposits (except consent agreements) received by the City of Hamilton or the former Regional Municipality of Hamilton-Wentworth. Although there are guidelines that clearly state that interest is to be paid in such circumstances, the Development Financial Officer often exercises her own discretion regarding whether or not to pay interest on deposits. This results in some deposits being refunded without interest while others with the same circumstances receiving interest. The rationale for the Development Financial Officer’s decisions is often not documented or approved by a senior official. While amounts are unlikely to be corporately significant given that large security deposits are often given in the form of letters of credit rather than cash deposits, there is a risk that the inconsistencies could create perceptions of preferential or unfair treatment.</td>
<td>That the Development Financial Officer adhere to the guidelines respecting the payment of interest on development related security deposits. That any deviations from the payment of interest on deposits, where applicable, be adequately documented and approved by the Manager of Capital Budgets and Development.</td>
<td>Agreed. Policies and guidelines will be developed and presented to Council to clarify when interest will be paid on security deposits. Agreed. Any deviations from the policies and guidelines noted above will be documented and approved by the Manager of Capital Budgets and Development.</td>
<td>Not Completed. Policies and guidelines have not been developed. After consultation with other municipalities about their methods, a report will be going to Council in the spring of 2011. Not Completed. As the policies and guidelines noted above have not been completed, there is no basis on which deviations can be assessed and thus documented or approved.</td>
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<td>Invalid and Redundant Letters of Credit</td>
<td>That a comprehensive inventory of all letters of credit in possession of the City be prepared by the Budgets and Finance Division.</td>
<td>Agreed. Student/temp(s) will be hired to develop a comprehensive inventory of all letters of credit.</td>
<td>Completed. A comprehensive inventory of all letters of credit has been developed and is updated on a regular basis.</td>
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<td>A significant proportion of development related deposits is held in the form of letters of credit (LCs) whose value is recorded in the registers as amounting to about $135 million at December 31, 2008.</td>
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<td>The validity of some letters of credit held by the City may be in question as:</td>
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<td>a. Some LCs established prior to amalgamation and registered in favour of former area municipalities still show the former municipalities as beneficiaries. There is no evidence that the banks processed an amendment replacing the former municipalities and naming the City of Hamilton as the new beneficiary.</td>
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<td>b. Some LCs in favour of former municipalities have not had any activity in them since amalgamation in 2001. A portion of these LCs date back to more than 15 years ago and are for work that should normally have been completed by now. There is a possibility that the LCs may have been cancelled by the developers or that the bank may not have renewed the LCs on their expiry dates. It is also possible that while the LCs may still be valid, the work for which they were required was long completed, rendering the LCs redundant.</td>
<td>That written confirmations of the validity of long outstanding LCs be obtained from financial institutions from which the LCs are drawn.</td>
<td>Agreed. This will be a shared work project between the Development Financial Officer and the resources referred to above.</td>
<td>Not Completed. Written confirmations have not been obtained from financial institutions and no timeline was provided as to when such confirmations will be attempted.</td>
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<td>An exercise carried out by the Planning and Economic Development Department in 2007 to identify invalid and redundant LCs no longer required by the City does not appear to have been completed.</td>
<td>That the Planning and Economic Development Department use the inventory listing to complete its review of LCs to determine if the LCs are still required and recommend the cancellation of LCs found to be redundant.</td>
<td>Agreed. See above.</td>
<td>Initiated. A review of the LCs commenced mid-2009 with summer students but the exercise ceased at the end of the term. This review is not a priority for management and will not be completed until further resources become available.</td>
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<td>4.</td>
<td>Reconciliation of General Ledger to LC Registers</td>
<td>That, in addition to recommendation 3. above, LC balances recorded in the General Ledger be reconciled to the updated registers every quarter.</td>
<td>Agreed. Upon finalization of a comprehensive inventory of LCs referred to in 3. above, adjustments will be made to the GL balance and then quarterly thereafter.</td>
<td>Not Completed. Copies of the registers were not attached to the reconciliation as supporting documentation. Electronic copies of the registers for the September reconciliations were not archived.</td>
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<td>Balances recorded in the General Ledger accounts differ from amounts recorded in LC registers. As at December 31, 2008 the General Ledger had a balance of $64,837,746 while balances in LC registers totalled $135,284,894, an unexplained difference of $70,447,148. The two records have never been reconciled, raising the risk that the large difference could be due to errors accumulated over several years and raising the question about the effort put into maintaining the registers when they appear to serve little purpose. The amounts recorded in the General Ledger are used in the notes to the annual audited financial statements. Further, some LCs included in the registers could not be traced to the actual LC instruments held in the vault. The majority of the discrepancies were due to the fact that the register was not updated when the LC was reduced, cashed or cancelled. In addition, included in some of the LC registers, were cash deposits received from developers. For these reasons, the reliability of the LC registers and the continued validity of some LCs listed therein are questionable. While LCs do not represent the City’s existing assets, they do provide some assurance that the City will have access to funds in the event of unsatisfactory performance by a developer. As such, it is important that LC recorded in registers be backed by valid instruments held in the vault.</td>
<td>That copies of the registers be attached to the reconciliation as supporting documentation.</td>
<td>Agreed. Copies of the registers will be attached to the reconciliation as supporting documentation.</td>
<td>Expected completion date – March 2010.</td>
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<td>5.</td>
<td>Register of Cash Deposits Held</td>
<td>That a detailed sub-ledger of cash deposits held in respect of site plan, subdivision and consent agreements be prepared by staff in the Budgets and Finance division. This ledger should be updated as changes occur and reconciled to the General Ledger balance on a quarterly basis.</td>
<td>Agreed. The Development Financial Officer will develop a detailed sub-ledger of cash deposits from the existing Excel spreadsheet. Once finalized, the sub-ledger will be reconciled to the GL quarterly. In addition, the Development Financial Officer will consider incorporating the sub-ledger into the PeopleSoft financial system. Expected completion date – July 2009.</td>
<td>Initiated. Even though quarterly reconciliations have been performed since March 2009, the sub-ledger balances did not match the PeopleSoft general ledger balances for the first two quarters of 2010 and the error was not found and adjusted until the third quarter. Management approved the reconciliations even though the sub-ledger and the general ledger did not reconcile. Stronger reconciliation controls are required.</td>
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Cash deposits held in respect of site plan, subdivision and consent agreements are only recorded in a General Ledger account which is not supported by a register. As such, there is no listing that provides comprehensive details of cash deposits held indicating the developer's name, the site name, dates of initial deposit and subsequent reductions.

A reconciliation of the General Ledger account that is prepared by the Development Financial Officer every quarter simply lists the debits and credits processed through the General Ledger account since the last reconciliation. Without a comprehensive register or sub-ledger, there is no assurance that balances recorded in the General Ledger are complete. In addition, the possibility that a developer will be refunded more than the amount originally deposited increases without such a register.

At December 31, 2008, cash deposits recorded in the General Ledger amounted to over $10 million.