RECOMMENDATION:

(a) That Report CM09014 respecting Audit Report 2009-01, Financial Requirements of Developments, be received; and

(b) That the management action plans as detailed in Appendix “A” of Report CM09014 be approved and the General Manager of Planning and Economic Development and the General Manager of Finance and Corporate Services direct the appropriate staff under their authority to have the plans implemented.

Ann Pekaruk
Director, Audit Services
City Manager’s Office

EXECUTIVE SUMMARY:
The 2008 Internal Audit work plan included an audit of the financial requirements of development originally noted on the deferred list. This involved the refundable security deposits required from developers to ensure work is carried out in accordance with approved site plans, lot grading and subdivisions. The review evaluated the security over cash and letters of credit held as deposit, the accuracy of amounts received as security deposits and interest calculations and the adequacy and reliability of controls over security reductions and deposit refunds.

The results of the audit are presented in a formal report containing observations, recommendations and management action plans, all attached as Appendix “A” of Report CM09014.
BACKGROUND:
The Planning and Economic Development Department receives and approves developers’ applications for site plans, lot grading and subdivisions. With these applications, the developers are required to pay refundable security deposits (cash or letters of credit) to ensure they carry out the work in accordance with the approved plans and applicable legislation. The Budgets and Finance Division of Corporate Services processes the security deposits.

At the request of the developer, security deposits can be refunded in whole or in part depending on the assessed value of incomplete works for which security is still required and if the City is satisfied that the work has been satisfactorily completed. Cash deposits accrue interest at the Bank of Canada, prime rate less 2%, payable when a refund is made.

As at December 31, 2008, the City’s General Ledger indicated $10.6 million in cash deposits and $64.8 million held as letters of credit. Interest paid on refunded cash deposits amounted to over $163,000.

The audit was completed in early 2009. The results of this work are attached as Appendix “A” of Report CM09014.

The Audit and Administration Committee receives and approves final audit and review reports as part of its responsibilities for the oversight of governance and control.

ANALYSIS/RATIONALE:
Internal Audit reviewed the processing of security deposits. In order to assess the security over the cash and letters of credit (LCs) held, Internal Audit performed physical verification of selected LCs.

The accuracy of amounts received and the interest paid upon refund (of cash deposits) was determined through re-calculation. The adequacy and reliability of controls over the custody of the security deposits was also assessed.

The audit resulted in the identification of areas for improvement, especially in regard to financial and administrative controls. A formal audit report containing observations, recommendations and management action plans was issued and is attached as Appendix “A” of Report CM09014.

The main recommendations noted in the report include:

- Restrictively endorsing cheques upon receipt and not accepting security deposits in the field.
- Paying interest as per the guidelines provided.
- Preparing a comprehensive inventory of all LCs held and reviewing the listing to ensure the LCs are still required. LC balances in the updated register should be reconciled to the General Ledger every quarter.
- Similar to the register for LCs recommended above, preparing a detailed sub-ledger of cash deposits held and a quarterly reconciliation to the General Ledger balance.
ALTERNATIVES FOR CONSIDERATION:
Not applicable.

FINANCIAL/STAFFING/LEGAL IMPLICATIONS:
Financial
Ensuring amounts noted in the financial statements and in the notes to these statements are supported by detailed sub-ledgers is a basic financial control.

Staffing
None.

Legal
Schedules included as part of Consent Agreements, Site Plan Agreements and Subdivision Agreements itemize fees and security deposits payable by the applicant.

POLICIES AFFECTING PROPOSAL:
Planning Act (requirement to collect performance securities).

RELEVANT CONSULTATION:
The attached report includes management action plans which reflect the responses of management and staff responsible for the collection and decision for refunding of security deposits (Planning and Economic Development Department) as well as the administration and retention of the instruments and their refunding (Budgets and Finance Division of Corporate Services Department).

CITY STRATEGIC COMMITMENT:
By evaluating the “Triple Bottom Line”, (community, environment, economic implications) we can make choices that create value across all three bottom lines, moving us closer to our vision for a sustainable community, and Provincial interests.

Community Well-Being is enhanced. ☐ Yes ☑ No
Security deposits are a means of ensuring development projects are carried out in accordance with standards set in the City’s Official Plan and Secondary Plan and the Ontario Building Code.

Environmental Well-Being is enhanced. ☑ Yes ☐ No
City Council's strategic commitment to "Best Practices - Best Value" under "A City That Spends Wisely and Invests Strategically" is addressed through audits and reviews and their subsequent follow up to ensure controls are in place to protect the assets of the City and promote efficient, effective and economic services and programs.

Does the option you are recommending create value across all three bottom lines? ☐ Yes ☑ No

Do the options you are recommending make Hamilton a City of choice for high performance public servants? ☑ Yes ☐ No

Attachment – Appendix “A”
## CITY OF HAMILTON
### AUDIT REPORT 2009-01
#### FINANCIAL REQUIREMENTS OF DEVELOPMENT

<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATION OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Handling of Cheques</td>
<td>That cheques be restrictively endorsed and logged upon initial receipt.</td>
<td>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.</td>
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<td></td>
<td>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.</td>
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<td>2</td>
<td>Inconsistencies in the Payment of Interest</td>
<td>That staff be directed not to accept developers’ security deposits in the field.</td>
<td>Agreed. Polices 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. Expected completion date – September 2009.</td>
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<td></td>
<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>
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### OBSERVATION OF EXISTING SYSTEM

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<tr>
<th>#</th>
<th>Invalid and Redundant Letters of Credit</th>
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| 3. | 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. The validity of some letters of credit held by the City may be in question as:

- **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.

- **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.

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.

### RECOMMENDATION FOR STRENGTHENING SYSTEM

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| 3. | That a comprehensive inventory of all letters of credit in possession of the City be prepared by the Budgets and Finance Division.

That written confirmations of the validity of long outstanding LCs be obtained from financial institutions from which the LCs are drawn.

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.

### MANAGEMENT ACTION PLAN

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| 3. | Agreed. Student/temp(s) will be hired to develop a comprehensive inventory of all letters of credit.

Agreed. This will be a shared work project between the Development Financial Officer and the resources referred to above.

Agreed. See above.

Expected completion date – March 2010.
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<tr>
<td>4.</td>
<td><strong>Reconciliation of General Ledger to LC Registers</strong></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>
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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.

That copies of the registers be attached to the reconciliation as supporting documentation.

Agreed. Copies of the registers will be attached to the reconciliation as supporting documentation.

Expected completion date – March 2010.
## Financial Requirements of Development

**March 2009**

### Appendix “A” to Report CM09014

<table>
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<tr>
<th>#</th>
<th>Observation of Existing System</th>
<th>Recommendation for Strengthening System</th>
<th>Management Action Plan</th>
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<tr>
<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>
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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.