



THE CORPORATION OF THE CITY OF VICTORIA

AUDIT FINAL REPORT TO MAYOR & COUNCIL

April 22, 2020

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SUMMARY

Our audit and therefore this report will not necessarily identify all matters that may be of interest to Council in fulfilling its responsibilities. This report has been prepared solely for the use of Council and should not be distributed without our prior consent. Consequently, we accept no responsibility to a third party that uses this communication.



Status of the Audit

As of the date of this report, we have substantially completed our audit of the 2019 financial statements, pending completion of the following items:

- ▶ Receipt of signed management representation letter
- ▶ Subsequent events review through to financial statement approval date
- ▶ Approval of financial statements by Council

We conducted our audit in accordance with Canadian generally accepted auditing standards. The objective of our audit was to obtain reasonable, not absolute, assurance about whether the financial statements are free from material misstatement.

The scope of the work performed was substantially the same as that described in our Planning Report to Council dated October 10, 2019.



Materiality

As communicated to you in our Planning Report to Council, preliminary materiality was \$3.5M. Final materiality remained unchanged from our preliminary assessment.



Audit Findings

Our audit focused on the risks specific to your operations and key accounts. Our discussion points below focus on areas of audit focus:

- ▶ Prior year adjustment
- ▶ COVID-19 disclosures
- ▶ Management override of internal controls
- ▶ Deferred revenue and government grants
- ▶ Cash and investments
- ▶ Staff salaries
- ▶ Tangible capital assets and accumulated amortization
- ▶ Employee future benefits
- ▶ Contaminated sites
- ▶ Development cost charges



Internal Control Matters

We are required to report to you in writing, any significant deficiencies in internal control that we have identified.

There were no significant control deficiencies noted that, in our opinion, are of sufficient importance to discuss with those charged with governance. However, please refer to Appendix D for the management letter which outlines recommendations over areas of operational improvement.



Independence

Our annual letter confirming our independence is included in Appendix A.



Adjusted and Unadjusted Differences

We have disclosed all significant adjusted and unadjusted differences and disclosure omissions identified through the course of our audit engagement. Each of these items has been discussed with management.

For purposes of our discussion, a summary of adjusted and unadjusted differences and disclosure omissions has been presented in [Appendix B](#).



Management Representations

During the course of our audit, management made certain representations to us. These representations were verbal or written and therefore explicit, or they were implied through the financial statements. Management provided representations in response to specific queries from us, as well as unsolicited representations. Such representations were part of the evidence gathered by us to be able to draw reasonable conclusions on which to base our audit opinion. These representations were documented by including in the audit working papers memoranda of discussions with management and written representations received from management.

A summary of the representation we have requested from management is set out in the representation letter included in Appendix C to the report.



Fraud Discussion

Through our planning process, and current and prior years' audits, we have developed an understanding of your oversight processes. We are not currently aware of any additional fraud affecting the company.

If you are aware of changes to processes or are aware of any instances of actual, suspected or alleged fraud affecting the City, since our discussions held at planning, we request that you provide us with this information.

Please refer to the Auditor's Responsibilities for Detecting Fraud in the Planning Report to Council.

AUDIT FINDINGS

As part of our ongoing communications with you, we are required to have a discussion on our views about significant qualitative aspects of the City's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. In order to have a frank and open discussion, these matters will be discussed verbally with you. A summary of the key discussion points are as follows:

KEY AUDIT AREAS

The following key findings and audit areas were identified based on our knowledge of the City's operations, our past experience, and knowledge gained from management.

Prior year restatement

Key Finding	Approach	Results
<p>During the audit it was brought to our attention that the accounting for deferred revenue had not been correctly executed in prior years, resulting in a correction to prior year amounts as previously reported. The amount does not exceed the materiality set for the engagement; however, management determined a prior year restatement was appropriate.</p> <p>A summary of the adjustment is disclosed in note 21 to the financial statements.</p>	<p>We discussed with management and examined documentation related to the restatement and determined there was no indication of intentional misstatement involved.</p> <p>We discussed with management the root cause of the misstatements and considered whether improvements to processes were necessary.</p> <p>We read management's disclosure in the financial statements and considered consistency with the facts.</p>	<p>We concur with management's assessment of the misstatement and the manner in which it has been corrected in the financial statements.</p> <p>We have reviewed the process for recording building permits and made recommendations to address this issue in Appendix D.</p>

COVID-19 disclosures

Key Finding	Approach	Results
<p>Subsequent to the year end the impact of COVID-19 on the Canadian and international economy substantially increased. Significant uncertainty in revenue generation and cash flow has arisen for all local governments.</p> <p>Management has included a note to the financial statements discussing the potential impacts to the City.</p>	<p>Discuss with management the potential impacts on the future operations and financial budgets and results for the City.</p> <p>Consider potential impacts in relation to other local governments in BC.</p> <p>Examine records subsequent to year end to determine if significant economic impacts have occurred to date.</p> <p>Consider the sufficiency of disclosure in the financial statements.</p>	<p>We concur with management's disclosures in the financial statements.</p>

Management Override of Controls

Key Audit Area	Approach	Results
<p>Management is in a unique position to perpetrate fraud because of management's ability to directly or indirectly manipulate accounting records, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p><i>This risk is required to be addressed for all audits pursuant to Canadian auditing standards.</i></p>	<p>Tested appropriateness of journal entries recorded in the general ledger, reviewed key estimates and other adjustments made in the preparation of the financial statements.</p> <p>Reviewed transactions recorded in the various ledgers for unusual or non-recurring adjustments not addressed by other audit procedures.</p> <p>Reviewed accounting estimates for biases and evaluated whether the circumstances producing the bias, if any, represented a risk of material misstatement due to fraud.</p>	<p>All audit testing in the area was executed as planned with no issues to be reported.</p>

Deferred Revenue and Government Grants

Key Audit Area	Approach	Results
<p>Accounting standards are complex and subject to potential misinterpretation. There is a risk that these charges grants are not appropriately calculated and recorded accordance with the relevant accounting standard.</p>	<p>Confirmed grant funding through review of agreements to ensure occurrence, and completeness.</p> <p>Reviewed whether revenue is recorded in accordance with the settlement of any stipulations in order to ensure accuracy.</p>	<p>All audit testing in the area was executed as planned with no issues to be reported.</p>

Cash and Investments

Key Audit Area	Approach	Results
<p>Cash planning and investment management are important aspects of good financial controls.</p> <p>Due to its nature, cash and investments is almost always considered to be a risk area in any audit.</p>	<p>Confirmed grant funding through review of agreements to ensure occurrence, and completeness.</p> <p>Reviewed whether revenue is recorded in accordance with the settlement of any stipulations in order to ensure accuracy.</p>	<p>All audit testing in the area was executed as planned with no issues to be reported.</p>

Staff Salaries

Key Audit Area	Approach	Results
<p>A significant single type of expenditure that covers many employees and departments. As a public entity, this figure is often of particular interest to financial statement users (taxpayers).</p>	<p>Performed systems testing, tests of controls and analytical review of staff salary and salary levels.</p>	<p>All audit testing in the area was executed as planned with no issues to be reported.</p>

Tangible Capital Assets and Accumulated Amortization

Key Audit Area	Approach	Results
Useful life estimates require periodic re-evaluation to determine if they are still accurate. This involves a high level of estimation and coordination of the finance department with other departments.	<p>Reviewed policies on procurement for major projects and reviewed actual expenditures to approved budgets.</p> <p>Tested a sample of asset acquisitions during the year to ensure they were accounted for appropriately under public sector accounting standards.</p> <p>Reviewed repairs and maintenance ledgers for possible capital items that have been expensed.</p> <p>Reviewed amortization policy and recalculated amortization for the year.</p>	<p>All audit testing in the area was executed as planned.</p> <p>During the audit, we noted that one asset had not been amortized in accordance with the City's policy and accounting standards, resulting in a significant misstatement. This error was corrected by management and is shown in Appendix B. We have made a recommendation in our management letter in Appendix D regarding the process.</p>

Employee Future Benefits

Key Audit Area	Approach	Results
A complex area that requires much estimation and reliance on actuarial experts.	<p>Reviewed actuarial reports and obtained assurance on the significant assumptions.</p> <p>Communicated with the external actuaries and evaluated their credentials, independence and assumptions used.</p>	All audit testing in the area was executed as planned with no issues to be reported.

Contaminated Sites

Key Audit Area	Approach	Results
This standard is complex and therefore there is a risk that liabilities may not be identified and appropriately accounted for.	Reviewed management's process on identifying new potential contaminated sites and management's assessment on whether a liability exists in accordance with the standard.	All audit testing in the area was executed as planned with no issues to be reported.

Development Cost Charges

Key Audit Area	Approach	Results
As with all municipalities, DCC collection is a complex area requiring interaction of several City departments. There is a risk that the DCCs may not be completely or properly charged or not used in accordance with the by-law.	Reviewed management's process for identifying the properties where new DCCs should be assessed and test that appropriate amounts collected. Performed procedures over the collection and use of funds in accordance with the relevant by-law.	All audit testing in the area was executed as planned with no issues to be reported.

INTERNAL CONTROL MATTERS

During the course of our audit, we performed the following procedures with respect to the City's internal control environment:

- ▶ Documented operating systems to assess the design and implementation of control activities that were relevant to the audit.
- ▶ Discussed and considered potential audit risks with management.

The results of these procedures were considered in determining the extent and nature of substantive audit testing required.

We are required to report to you in writing, significant deficiencies in internal control that we have identified during the audit. A significant deficiency is defined as a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

As the purpose of the audit is for us to express an opinion on the City's financial statements, our audit cannot be expected to disclose all matters that may be of interest to you. As part of our work, we considered internal control relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. This work was not for the purpose of expressing an opinion on the effectiveness of internal control. We did not note any significant deficiencies that require the attention of the Board. Our management letter outlining improvement opportunities is in Appendix D.

OTHER REQUIRED COMMUNICATIONS

Potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements.

- BDO Response: Disclosed as required

Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern.

- BDO Response: None noted

Disagreements with management about matters that, individually or in the aggregate, could be significant to the entity's financial statements or our audit report.

- BDO Response: None noted

Matters involving non-compliance with laws and regulations.

- BDO Response: None noted

Significant related party transactions that are not in the normal course of operations and which involve significant judgments made by management concerning measurement or disclosure.

- BDO Response: None noted

Management consultation with other accountants about significant auditing and accounting matters.

- BDO Response: None noted

Other Matters

- BDO Response: None noted

Professional standards require independent auditors to communicate with those charged with governance certain matters in relation to an audit. In addition to the points communicated within this letter, the attached table summarizes these additional required communications.

APPENDICES

Appendix A: Independence update

Appendix B: Adjusted and unadjusted differences

Appendix C: Representation letter

Appendix D: Management Letter

APPENDIX A: INDEPENDENCE UPDATE

April 22, 2020

Members of the Council
The Corporation of the City of Victoria

Dear Council Members:

We have been engaged to audit the financial statements of The Corporation of the City of Victoria (the "City") for the year ended December 31, 2019.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the City and our Firm that, in our professional judgment, 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 appropriate provincial institute/order and applicable legislation, covering such matters as:

- Holding a financial interest, either directly or indirectly in a client;
- Holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
- Personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
- Economic dependence on a client; and
- Provision of services in addition to the audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters arising since October 10, 2019, the date of our last letter.

We are not aware of any relationships between the City and our Firm that, in our professional judgment may reasonably be thought to bear on independence that have occurred from October 10, 2019 to April 15, 2020.

We hereby confirm that we are independent with respect to the City within the meaning of the Code of Professional Conduct of the Chartered Professional Accountants of British Columbia as of April 15, 2020.

This letter is intended solely for the use of the Audit Committee, the Council, management and others within the City and should not be used for any other purposes.

Yours truly,

BDO Canada LLP

Chartered Professional Accountants

APPENDIX B: ADJUSTED AND UNADJUSTED DIFFERENCES

SUMMARY OF ADJUSTED DIFFERENCES

The following is a summary of differences that were corrected by management during the course of our audit engagement:

	Increase (Decrease)			
	Assets	Liabilities	Equity	Net Income
Dr. Amortization expense				\$ 1,373,203
Cr. Accumulated amortization	\$ (1,373,203)			
To adjust amortization for assets that were put in use in the year and amortization had not been calculated.				
Dr. Accounts payable and accrued liabilities		\$ 530,695		
Cr. Prepaid expenses	\$ (530,695)			
To reverse insurance premiums recorded as prepaid expenses that had not been paid at the end of the year.				
Dr. Deferred revenue		\$ 2,608,713		
Cr. Accumulated surplus			\$ (2,608,713)	
To reflect revenue from permits where performance by the City was undertaken or completed in prior years.				
Total Adjusted Differences	\$ (1,903,898)	\$ 3,139,408	\$ (2,608,713)	\$ 1,373,203

SUMMARY OF UNADJUSTED MISSTATEMENTS AND DISCLOSURE OMISSIONS

There were no unadjusted misstatements or material disclosure omissions noted during the course of our audit engagement.

APPENDIX C: REPRESENTATION LETTER

BDO Canada LLP
Chartered Professional Accountants
Suite 500
1830 Douglas Street
Victoria, BC
V8T 5C3

This representation letter is provided in connection with your audit of the financial statements of The Corporation of the City of Victoria for the year ended December 31, 2019, for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, in accordance with Canadian public sector accounting standards.

We confirm that to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Financial Statements

We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated October 31, 2016, for the preparation of the financial statements in accordance with Canadian public sector accounting standards; in particular, the financial statements are fairly presented in accordance therewith.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of Canadian public sector accounting standards.
- All events subsequent to the date of the financial statements and for which Canadian public sector accounting standards require adjustment or disclosure have been adjusted or disclosed.
- The financial statements of the entity use appropriate accounting policies that have been properly disclosed and consistently applied.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter.
- We have reviewed and approved all journal entries recommended by the practitioners during the audit. A list of the journal entries is attached to the representation letter.

Information Provided

- 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;
 - additional information that you have requested from us for the purpose of the audit; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

- We are responsible for the design, implementation and maintenance of internal controls to prevent, detect and correct fraud and error, and have communicated to you all deficiencies in internal control of which we are aware.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

Fraud and Error

- 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.
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - management;
 - employees who have significant roles in internal control; or
 - others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators, or others.

General Representations

- Where the value of any asset has been impaired, an appropriate provision has been made in the financial statements or has otherwise been disclosed to you.
- We have provided you with significant assumptions that in our opinion are reasonable and appropriately reflect our intent and ability to carry out specific courses of action on behalf of the entity when relevant to the use of fair value measurements or disclosures in the financial statements.
- We confirm that there are no derivatives or off-balance sheet financial instruments held at year end that have not been properly recorded or disclosed in the financial statements.
- Except as disclosed in the financial statements, there have been no changes to title, control over assets, liens or assets pledged as security for liabilities or collateral.
- The entity has complied with all provisions in its agreements related to debt and there were no defaults in principal or interest, or in the covenants and conditions contained in such agreements.
- There have been no plans or intentions that may materially affect the recognition, measurement, presentation or disclosure of assets and liabilities (actual and contingent).
- The nature of all material uncertainties have been appropriately measured and disclosed in the financial statements, including all estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

- There were no direct contingencies or provisions (including those associated with guarantees or indemnification provisions), unusual contractual obligations nor any substantial commitments, whether oral or written, other than in the ordinary course of business, which would materially affect the financial statements or financial position of the entity, except as disclosed in the financial statements.

Other Representations Where the Situation Exists

- We have provided you all the relevant information in order to appropriately record and disclose the restatement made to correct a material misstatement in the prior period financial statements that affect the comparative information. This restatement was for:
 - adjusting overstatement of deferred revenue and understatement of permit revenue.
- The financial statements and any other information in the annual report provided to you prior to the date of this representation letter are consistent with one another, and there is no material misstatement of the other information. We have provided you with the final version of the document(s) comprising the annual report.
- We have informed you of all known actual or possible litigation and claims, whether or not they have been discussed with legal counsel. When applicable, these litigation and claims have been accounted for and disclosed in the financial statements.
- We have considered the impact of COVID-19 on the amounts and disclosures in the financial statements. To the best of our knowledge and belief, we have disclosed all known impacts and risks to the City.

Yours truly,

Susanne Thompson,

Position

Laurel Westinghouse

Position

APPENDIX D: MANAGEMENT LETTER

April 22, 2019

Susanne Thompson, CPA, CGA, Deputy City Manager/CFO
The Corporation of the City of Victoria
1 Centennial Square
Victoria, BC V8W 1P6

Dear Ms. Thompson:

RE: Auditor's Management Letter

As your external auditors we are engaged to provide an audit opinion on your year-end financial statements. An external audit requires testing of transactions and balances and review of those internal control systems upon which we may place reliance. A positive opinion on the financial statements does not necessarily mean that your internal control systems are all operating effectively. This is because we review only those internal control systems where we feel that failure in those systems could result in a material error on the financial statements. With those systems that we do review, our focus is on the assertions necessary to meet our financial statement audit objectives.

Our review of systems, transactions and balances as well as discussions with staff at various levels throughout the City gives us a unique insight into your operations. While conducting this work we make note of items that come to our attention where we feel that improvement could be made or alternatives could be considered. We are fortunate in that we work with a great number of clients and observe a wide variety of processes. We see firsthand any procedures that are emerging as best practices.

We are required to report to you in writing, significant deficiencies in internal control that we have identified during the audit. A significant deficiency is defined as a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

As matters come to our attention we make note of these for subsequent follow-up. For minor matters, we discuss directly with the staff involved. More important matters are brought forward in this letter (known as a management letter). We did not note any significant deficiencies in internal control in the current year; however, we do have a number of areas we noted for potential improvement, as well as areas noted in prior years, with updates to the status. Where points raised in prior years are no longer applicable we have removed them from the letter.

This letter is a by-product of our audit and the points noted are not necessarily indicative of significant problems with your systems or staff. Our role as auditors includes making recommendations where we see improvement opportunities.

This letter is solely for the use of Council and Management in discharging their responsibilities over financial reporting and should not be used for any other purpose. We accept no responsibility for any other use of this letter.

Current Year Recommendations

1. Asset Retirement Obligation

Asset retirement obligations is a new Public Sector Accounting Standard that will be required to be applied in the financial statements for the year ended December 31, 2022, with optional retroactive application. While this standard has been discussed often since first introduced, the time frame for assessing and applying that standard is steadily decreasing.

Ensuring that the City has a detailed action plan to assess, calculate and record the asset retirement obligation will help ensure that the application of this standard will be reasonable. This action plan will also help ensure that the resources are available to meet the requirements of the standard.

We will continue to be a resource, and to work with management in the lead up to the implementation date of January 1, 2022.

Management's Comment

The City has begun preparations to meet the requirements of this reporting standard and City staff have joined a working group organized by the Government Finance Officers Association of BC (GFOABC) to combine efforts, share learnings and develop best practices with municipal finance staff throughout BC. City staff appreciate that BDO is also a resource in this area.

2. Building Permit Revenue

During the audit, management brought to our attention that there had been an error in the amount of revenue recognized for building permits. Previously, management recorded cash receipts for approved permits as revenue, and subsequently recorded a journal entry to defer the unearned portion of open permits only at year end. The listing used to calculate the journal entry included permits that were still in the approval process.

We recommend that management adjust their process to:

- Record cash receipts for approved building permits to a deferred revenue account.
- Regularly (preferably monthly but at least quarterly) review the listing of permits approved and assess the amount of revenue to recognize based on stage of completion/progress of permits.
- Record journal entry to recognize the amount of revenue earned during the period as the review process and inspections are completed.

This approach will show the work that is performed on these permits throughout the year and provide a better analysis on the performance of building permits. In addition, errors such as the one identified will be reduced as only amounts relating to permits progressing will have revenue recorded.

Management's Comment

Financial analysis work by City staff during the year end preparation procedures identified the process error, which has now been revised to capture the correct revenue when calculating the portion to be deferred. The corrected revenue calculation aligns with the City's quarterly revenue reporting to Council. Management does not recommend the suggested change as the proposed approach would add workload to the Permits and Inspections staff in the Sustainable Planning and Community Development Department and the cost of the resulting effort would exceed the value added.

3. Amortization Expense

During the audit, we noted that amortization had been calculated incorrectly and resulted in a significant adjustment that was corrected in Appendix B.

We note from our testing that the amortization expense is run manually in Excel during the year-end financial statement preparation process. As a result, errors in the calculation of amortization are possible due to broken formulas and inadvertent data manipulation. The use of Excel in developing accounting entries is particularly error prone unless strict controls are incorporated over access to formulas and data entry.

We recommend that management consider ways to automate the amortization process and include more frequent performance of the process. This encourages more frequent reviews of on-going and completed capital projects and the calculation of amortization, thereby reducing the risk of errors not being detected on a timely basis.

Management's Comment

The calculations for Tangible Capital Asset reporting are complex and require multiple steps. Through the combined effort of IT and Finance, City staff have developed automated reporting tools for a number of the steps, thereby reducing the reliance on manual excel procedures where possible. Staff remain committed to considering opportunities to increase reporting automation and reduce reliance on manual procedures.

Management does not recommend calculating amortization more frequently during the year as this is a financial statement reporting requirement that is based on the past cost of assets purchased and is not consistent with the financial planning process which is focused on future replacement requirements.

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

We would like to express our appreciation for the co-operation and assistance which we received from the City's management during the course of the audit.

We are pleased to discuss with you further any matters mentioned in this letter at your convenience.

Yours truly,



Brian Szabo, CPA, CA
Partner through a corporation
BDO Canada LLP
Chartered Professional Accountants

BJS/jaw

CC: MAYOR AND COUNCIL