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PRIVATE & CONFIDENTIAL

Nelson Chan
Chief Financial Officer,
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Capital Regional District
625 Fisgard Street
Victoria, BC
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April 9, 2025

Dear Mr. Chan:

Re: Reporting on internal control matters

In planning and performing our audit of the consolidated financial statements of Capital Regional District ("the District") for the period ended December 31, 2024, we obtained an understanding of internal control over financial reporting (ICFR) relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on ICFR. Accordingly, we do not express an opinion on the effectiveness of the District's ICFR.

Our understanding of ICFR was for the limited purpose described above and was not designed to identify all control deficiencies that might be significant deficiencies and therefore, there can be no assurance that all significant deficiencies and other control deficiencies have been identified. As a result, any matters reported below are limited to those deficiencies in ICFR that we identified during the audit.

Our awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

IDENTIFICATION

We did not identify any significant deficiencies in internal control.

Refer to the Appendix B for the definitions of various control deficiencies.

OTHER CONTROL MATTERS

We identified certain control matters that have not been communicated to management by other parties and that, in our professional judgment, are of sufficient importance to merit management's attention. Refer to Appendix A. There were no new control observations identified in the current year.

MANAGEMENT'S RESPONSES

Management's responses have not been subjected to the audit procedures applied in the audit, and accordingly, we express no opinion on them.

USE OF LETTER

This letter is for the use of management and those charged with governance in carrying out and discharging their responsibilities and should not be used for any other purpose or anyone other than management and those charged with governance. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this letter has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Yours very truly,

KPMG LLP

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Appendix A — Update on Previous Year's Continuing Other Control Matters

1. Adoption of New Accounting Standards

Observation and implication:

The District adopted PS 3400 *Revenue* in fiscal 2024 and PS 3280 *Asset retirement obligations* in 2023. As part of the adoption process, management had to evaluate the completeness of revenue in the financial statements under the new accounting standard, as well as document the performance obligations of each revenue source, or the activities required in order to earn the revenue recognized. Completeness of liabilities and commitments were evaluated as part of the adoption process for asset retirement obligations in 2023. This was a significant amount of effort and required Finance to have knowledge of the material contracts, strategic partnerships, and unique multi-party, multi-year contracts entered into by the District's various departments to enable it to make the required representations regarding accuracy and completeness.

Update from 2024 audit:

The Finance team is increasingly dependent on information from and expertise of other departments within the District in order to prepare accurate financial statements. Examples of such information include contract commitments, legal negotiations, landfill fill rates, tangible capital asset transactions and related retirement obligations.

Management is undergoing development of a centralized SharePoint corporate contract management system, which will enhance internal controls related to certification or attestation of internal information by other departments.

Management has made significant progress to improve transparency of information between departments. In 2024, management adopted PS 3400 *Revenue*, which required extensive work to understand existing contracts in place across departments and any associated revenue streams. No issues were identified by management as part of the adoption of PS 3400 *Revenue*, nor through the audit process for adoption of the new standard. Furthermore, we did not identify any issues in testing performed over contractual obligations and contractual rights. This finding is now considered closed.

2. Recurring financial reporting adjusting entries

Observation and implication:

During our audit, we noted that many manual adjusting entries required for financial reporting are not recorded in SAP but are recorded each year end as "PSAB" entries. These entries are tracked in excel and are the trail to reconciling balances in SAP to the final audited financial statements. Tracking these entries in excel rather than directly in SAP increases the risk entries are incorrect, incomplete or knowledge of their source is lost during unexpected employee turnover or extended leave.

Update from 2024 audit:

We note that management has performed significant analysis over how these entries would be input directly into SAP. Certain entries were migrated to SAP in 2020 and are no longer adjusted manually. For the remaining entries not migrated to SAP, based on the current general ledger structure, there are significant complexities to being able to record these in SAP.

In 2022, management started work on S/4HANA and general ledger structure projects, including evaluating a new chart of account structure to support recording all transactions directly in SAP. Management has identified a need for business transformation beyond financial reporting requirements to reduce manual processes related to core finance activities, enhance access to real time performance insights using financial data and leverage technology to serve the needs of the business in a more efficient and effective manner, to support alignment with the District's strategic objectives.

Until the migration takes place, management has maintained its process of recording manual "PSAB" entries, but has significantly enhanced the control environment around such entries, including more detailed documentation regarding the rationale for each entry and the calculation of the amount, as well as the audit trail to support each entry. Additional training has and will continue to be provided to finance team members on public sector accounting standards to further enhance and embed knowledge of these entries in preparation for the integration with SAP.

Management is continuing its work on S/4HANA and general ledger structure projects, including evaluating a new chart of account structure, and business process review to reduce manual processes related to finance activities. In 2024, the Phase 1 of the S/4HANA system upgrade was completed with no issues regarding accuracy of inputting the closing trial balance into the new system for use on a go forward basis. In 2025, Phase 2 of the project is expected to be completed, which will include incorporation of PSAB entries into the S/4HANA system.

Recommendation:

The manual "PSAB" entries continue to pose a high risk on the accuracy of financial reporting due to their complexities and we recommend management continue to enhance the controls around these entries and work towards integration of the entries when migrating to S/4HANA.We acknowledge the progress that has been made to date on enhancing controls around these entries and support management's longer term plan to integrate the entries when migrating to S/4HANA.

Management Response:

Management took steps to bring several "PSAB" entries into SAP in 2024 in preparation for Phase 2 of the S4 Hana upgrade project that will be completed in the summer of 2025. Management is currently making updates to accounting processes and leveraging several features available in S/4 HANA to assist with bringing the remaining "PSAB" adjustments into SAP by the end of 2025.

3. IT Control Environment

Observation and implication:

As the entity continues to grow, enhances its use of technology through modernization of its systems and processes and cyber breach attempts become more prevalent for all organizations, there is increased risk that gaps in the IT control environment can lead to business interruption and reputation risk.

We understand that management has performed an internal assessment of general IT controls, which has identified opportunities to strengthen the IT control environment, for example consistent access controls for all systems and continuous education to keep team members up to date on their role in cybersecurity across the organization. Management is working to address the recommendations identified from that assessment, with a number of improvements actioned since the date of this assessment.

Update from 2024 audit:

Management has made significant progress to address recommendations noted from its general IT control environment review. Key milestones include implementation of an IT Change Management process and IT Change Advisory Committee, cybersecurity assessment and tabletop exercise to simulate response to a ransomware incident, enhanced monitoring and incident response planning, password security policy and Corporate Acceptable Use Policy. We acknowledge that with IT systems, there is an element of residual risk due to complexity of systems and inability to reduce risk to zero, which requires continuous monitoring and improvement of existing policies. This finding is now considered closed and management will continue to monitor and make continuous improvements as part of regular operations.

4. Investment Policy

Observation and implication:

We noted that based on the historical size of the investment portfolio and relative stability in interest rates, management calculates accrued interest on fixed-income investments using a straight-line formula over the investment term. This results in the same dollar amount of interest income being recognized over the duration of the investment. Accounting standards require interest be measured using the effective interest method, which results in a constant rate of return taking into consideration compound interest earned during the term. Due to quickly and frequently rising interest rates in 2023, a larger difference was noted between management's interest income calculation and requirements of accounting standards. The same amount of interest is recognized over the entire term of the investment, but using CRD's current method, there is an overstatement of interest in the early years of the investment term, and understatement in the later years. As a percentage of the overall investment portfolio of $369M, we noted a 0.1% difference in portfolio value and a 2.3% difference in interest income in 2023 ($15.2M total interest income recognized). Although the existing calculation method does not lead to a material difference in accrued interest, it could lead to a material difference as the investment balance continues to grow over time and if larger value, longer term, fixed-income investments continue to be purchased. We also note that management's investment policy is currently silent on the method for calculating interest income.

Update from 2024 audit:

Management has taken steps to implement a calculation that follows effective interest rate methods for recording investment income. We did not identify any issues during our audit. This finding is now considered closed.

5. **Tangible Capital Asset Process**

Observation and implication:

Our testing performed over the tangible capital asset process highlighted the manual nature of the process (capitalization, amortization, revaluation, classification) and resulting potential risk of error. We identified an opportunity to mitigate risks by leveraging technology enhancements and evaluating if existing monitoring controls continue to be sufficient for the growing size of the capital asset portfolio. In addition, after the initial adoption of accounting standards for asset retirement obligations in 2023, in future years, management will need to implement new processes and controls to maintain the accuracy of these estimates in its financial reporting.

Management is placing enhanced efforts on its review controls to monitor capital additions as they arise to reduce the amount of adjustments required subsequent to their recognition.

Update from 2024 audit:

Through testing over work-in-progress transfers, we identified $2.8 million in assets that were substantially complete in prior years but not transferred to the applicable asset category as in use or amortized until 2024. This resulted in an understatement of amortization in prior years and overstatement in 2024 and future years, to accelerate amortization expense over the remaining useful life of the capital assets rather than the full expected useful life.

While progress has been made to improve this process, there is still a manual element to this process. We acknowledge that work is underway with the SAP S4/HANA upgrade project, with the goal of streamlining certain elements of the capital asset process through better alignment to the entity's reporting needs.

Recommendation:

We encourage management's efforts to evaluate the nature, communication and sufficiency of its internal controls related to reviewing the accuracy, classification and useful life of tangible capital asset additions as they occur and throughout their useful life.

Management response:

Updates to the chart of accounts and accounting processes are underway through Phase 2 of the S/4HANA upgrade project that will be completed summer of 2025. The improvements will simplify the CRD's accounting processes for tangible capital assets reducing the need for manual adjustments and promote the frequency of accounting for assets.

Management is reviewing it's existing processes in context to the S/4 HANA changes underway and evaluating further opportunities to address the challenges relating to improving communication in a decentralized environment.

Appendix B – Definitions

Terminology	Definition
DEFICIENCY IN INTERNAL CONTROL	A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing; or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively.
SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL	A significant deficiency in internal control is 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.