

Capital Regional District Management Letter



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PRIVATE & CONFIDENTIAL

Nelson Chan
Chief Financial Officer
Capital Regional District
625 Fisgard Street
Victoria, BC V8W 2S6

May 4, 2022

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, 2021, 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 D for the definitions of various control deficiencies.



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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 Appendices A, B and C.

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,

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a horizontal line that starts under the 'K' and ends under the 'P'.

Chartered Professional Accountants



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Appendix A — Current Year Other Control Matters

1. Adoption of New Accounting Standards

Observation and implication:

The District will be required to adopt new accounting standards in fiscal 2023 and 2024, PS 3280 *Asset retirement obligations*, PS 3400 *Revenue* and PS 3160 *Public private partnerships* in 2023-2024. As part of the adoption process, management will need to evaluate and attest to the completeness of liabilities, commitments and revenue in the financial statements under these new accounting standards. This will be a significant amount of effort and requires 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.

Recommendation:

We recommend Finance continue internal education related to adoption of these standards and the Executive Leadership Team hold departments accountable for evaluating completeness of contractual obligations and reporting relevant information in alignment with these standards. A comprehensive understanding of contracts and commitments will support management in its efforts to gain assurance over the completeness of liabilities, commitments and revenue in its budgeting and financial reporting activities.

Management Response:

Recommendations are taken under advisement. As the contracts review process is applied across the organization with a wide scale of agreements, management will continue the existing education plan and investigate areas of concern and implement improvements where necessary.



Appendix B – Update on Previous Year’s Continuing Other Control Matters

1. 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 2021 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. It is expected that through the S/4HANA migration and general ledger structure projects, the ability to record these entries in SAP will become more common practice.

Until the S/4HANA 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.

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 continues to improve processes and supporting documentation for the year end (manual) “PSAB” entries. As an example, in 2021, the entries were transferred into new workbooks that provide greater transparency and are more flexible to future adjustments when necessary. The new workbooks allow for a simpler process and more transparent audit trail to support the “PSAB” entries, significantly shortening review time and reducing risk of error. The work to integrate these entries into SAP will be addressed within the 2023 S4/Hana Initiative Business Case (IBC) which is proposed for the 2023/2024 service planning cycle.



Appendix C – Update on Previous Year’s Closed Other Control Matters

1. Amortization Policy

Observation and implication:

During our procedures over amortization expense, it was noted that management has an accounting practice, whereby newly constructed or purchased assets are not amortized until the year after they are placed in use due to the District’s annual capitalization process occurring at year-end. Capital Region Housing Corporation also has an accounting practice for amortization. However, the Corporation’s practice is to recognize a full year of amortization in the year the asset is placed in use. Current amortization practices could result in material differences when comparing amortization recognized and amortization calculated from an in-use date.

Update from 2021 Audit:

A new procedure was implemented in 2021 for the District, Capital Region Housing Corporation and Capital Regional Hospital District where all new assets greater than a certain threshold begin amortization at the start of the month that the asset is put into productive use. Assets below the threshold are amortized using the half-year rule in the year they are put into productive use.

2. Reporting of Serious Misconduct Policy

Observation and implication:

The District has a policy entitled ‘Reporting of Serious Misconduct’ that describes the principles and procedures for reporting and investigating serious misconduct. A definition of serious misconduct is included in the policy, and a reporting matrix exists for communication of such matters through General Managers, the Chief Administrative Officer and Board, depending on nature and severity.

The definition of serious misconduct includes allegations such as misappropriation of funds, theft, embezzlement, kickbacks, bribes and exposure to significant financial loss, however, the Chief Financial Officer is not included in the communication matrix of those that shall be immediately informed of allegations. This information gap can result in a lack of information related to financial risks, inaccurate financial reporting, non-compliance and misinformed decision making.

In addition, we noted the hierarchy matrix remains within the chain of command of the complainant, for example, concerns are escalated through their direct supervisor, manager and General Manager. This could result in management bias and/or conflict of interest in evaluating the validity of the allegations. There is no description of when an independent, third party reviewer would be engaged to conduct the assessment rather than management.

Update from 2021 Audit:

The Reporting and Serious Misconduct Policy was updated and was published internally for all staff. This policy incorporates the Chief Financial Officer into the communication matrix for any complaints that have real or perceived financial implications. Additionally, for complaints where the allegation relates to a colleague, supervisor, or section manager, the reporting hierarchy allows the individual to report the matter to the Senior Manager of Human Resources. The policy was also updated to provide additional clarity as to when a third party reviewer will be used to investigate an allegation.



3. Purchase and Payment Process - Cutoff

Observation and implication:

During our sampling of transactions related to contract for service and consultants expense, we identified an invoice for an environmental survey that was conducted in 2018, with the final deliverable received in 2019; financial services had not been informed of the potential accrual. The amount of the invoice exceeds the \$100,000 internal threshold set for the application of accruals, and therefore required an expense and accrued liability to be recorded in 2018. Instead, the amount was recorded as an expense in 2019. Contracts are subject to extended terms of service and if not recorded in the correct period, could result in expenses being recorded in the incorrect fiscal year.

We noted management has made efforts in 2019 and 2020 to review significant accruals and outstanding balance sheet items during the year-end closing process which will continue to promote more accurate accruals and minimize the impact of such cut-off discrepancies. This is a significant undertaking by the Finance team because invoices are received by departments for initial review before being approved and sent to Finance for recording and payment. The existing process can result in payments being made 1-3 months past their due date. Such cut-off discrepancies have been identified by management in previous years.

Update from 2021 Audit:

Management continues to communicate the importance of cut-off to all staff through meetings and quarterly close procedures correspondence. Subsequent disbursements and receipts testing is performed internally after year-end to detect possible cut-off issues. A long-term ambition the District continues to explore is to have a centralized purchase and payment process to further reduce the risks around cut-off.

4. Expense Report Process – Approval of Board of Directors Expense Reimbursement

Observation and implication:

During our review of Board of Directors' expense reports, we noted that one expense report inspected was approved by an employee not part of the Executive Team. The District's policy is that expense reports related to Board of Directors be approved by the Chief Financial Officer (or alternate member of the Executive Team if not available). KPMG noted that this expense related to an event where the Director was not acting in their capacity as a Board Member, but acting in their capacity as a Chair of a Commission. The budget for meetings of this Commission is assigned to a manager at CRD.

Update from 2021 Audit:

A revised Board Remuneration Policy was approved by the Governance Committee on December 8, 2021 and published internally on January 24, 2022. This policy covers Board Directors, Commission members and First Nation members and includes clarification on the approval process.



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5. Expense Report Process - Approval of Chief Administrative Officer Expense Reimbursement

Observation and implication:

During our review of expense reports, we noted that the CAO's expense reports are reviewed and authorized for reimbursement by the CFO, not the Board of Directors. As best practice, expense reports should be approved by an employee's supervisor.

As a preventative control, a guideline was implemented in 2017 requiring the CAO to complete a Training and Development Request form and obtain pre-approval by the Board Chair before the CAO is able to travel or attend an event. As per the guidelines of the pre-approval form, the signed document is kept in the employee's file in the custody and control of the Human Resources department.

Update from 2021 Audit:

All expense claims submitted by the CAO are approved by the Chair of the Board. KPMG selected one CAO expense claim from 2021 and verified it followed the new approval process. A new consolidated expense reimbursement policy will be drafted in 2022 that will be applicable for all employees and formalize this practice.



Appendix D – 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.