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PRIVATE & CONFIDENTIAL

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

May 5, 2021

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, 2020, we obtained an understanding of internal control over financial reporting (ICFR) relevant to the District's preparation 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 consideration 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.

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,

KPMG LLP

Chartered Professional Accountants

Appendix A — Current Year 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.

Recommendation:
We recommend management assesses the consistency of practice between the District and Corporation. With higher value property purchases and large-scale capital projects, the policy should also include guidance on how to calculate amortization on material new assets.

Management Response:
As part of the Corporate Asset Management Strategy, a revision to the tangible capital asset policy is underway. The revision includes enhanced accounting practices for asset componentization, useful life, depreciation, criticality and condition of assets. The recommendation to align across entities and to introduce a more precise calculation in the first year of an asset does align with internal findings and will be incorporated into the revised version. Implementation of the revised policy is currently anticipated for the 2022 calendar year. For 2021, a review will be performed on all significant assets being placed into use in the year and amortization will be calculated based on when they are placed into use.

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 2020 Audit:
During our audit, we noted the number of manual entries was consistent with previous years. The documentation trail remains complex; however, the finance team's understanding and explanation of amounts had improved. The District is in the process of reviewing its internal controls over financial reporting to assess whether there are alternate methods of recognizing the above entries.

Recommendation:
We recommend that management continue to prioritize the review and integration of year end adjusting journal entries into the system trial balance rather than through manual excel adjustments. Further, we recommend as the District moves to recording entries in SAP where possible, that a continued focus remain on developing clear documentation to facilitate transfer of knowledge between individuals should unexpected employee turnover or extended leave occur.

Management Response:
During 2020, the system was developed to allow corporate level closing entries to be posted in the system. For the 2020 year-end a number of entries were migrated to SAP and are no longer adjusted manually. In addition, analysis was performed on the remaining manual entries and migration of more entries is planned for the 2021 year-end.

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.

Recommendation:
We recommend the District's policy be reviewed with the following considerations:
- Include the Chief Financial Officer in the communication matrix for any financial allegations;
- Modify the reporting hierarchy to ensure independence in the review process so an individual who is not a direct supervisor is assessing the claim, if internal resources are evaluating the claim;
- Identify when a third party reviewer would be used to assess claims, for example, when related to Board or senior leadership members.

We also recommend communication on a routine basis with management teams of the District's policy towards reporting serious misconduct, risk tolerance towards allegations, and clarification of examples of misconduct. Establishing a strong tone at the top regarding expectations of communication of any allegations is important as a preventative and detective measure, and enables matters to be investigated promptly.

Enhance tracking of allegations in a manner similar to the District's legal claims (a complete and ongoing listing of any matters the District is aware of). This assist with providing the District with a more comprehensive view of such activity, risk mitigation measures and other responses, as needed. We recommend regular reporting to the senior leadership team similar to legal matters take place to encourage awareness, discussion and visibility over how such matters are expected to be assessed.

Management Response:
Recommendations on reporting and design of the policy is taken under advisement. As this is a Board adopted policy, management will integrate various improvements in the next revision for consideration. Management has planned revisions to the Reporting of Serious Misconduct Policy to address recommendations from KPMG. The policy will now have to go through the review process and final board approval.

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.

Recommendation:
We recommend that management evaluate the existing process for processing invoices and consider opportunities to enhance awareness and communication of commitments by departments to the Finance team. Many organizations direct invoices to the Finance team upon receipt for recognition of an expense, then send them to the approving department for review and authorization to pay. This may be a more efficient process for both informing Finance of invoices received and obtaining department approval because Finance can follow up if documents are misplaced. Enhanced line of sight into the existence of invoices upon receipt will provide more complete information to Finance for accurate financial reporting.

Management Response:
The current process is for invoices to be received by vendor contacts across the organization, reviewed for goods and services receipt, coded, approved, and then submitted to Financial Services for payment processing. This process results in varied end-to-end process timing of up to 6 months, limiting the ability to accurately record expenses within a reporting period. Management will evaluate an organization wide change in business process for potential implementation in future years. Management will also continue to perform outreach and education to ensure timely and accurate reporting within a reporting period.

Management implemented an additional control procedure requiring the Manager of Financial Reporting, to review all invoices exceeding $100,000 for potential cut-off issues to determine if the invoice requires accrual into the reporting period if not already accrued for.

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.

Recommendation:
We recommend that the District's policy be updated to clarify the approval process for expenses related to other related entities, Commissions or Boards.

Management Response:
Recommendations on improvements to the existing policy is taken under advisement. As this is linked to a Board adopted policy, management will integrate various improvements in the next revision for consideration.

Management will also continue to perform outreach and education to ensure timely and accurate reporting.

Management has drafted revisions to the Board Remuneration and Travel Expense Reimbursement policy to address recommendations noted by KPMG. The revised policy will also go through the review and approval process to obtain board approval.

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 2020 Audit:
During our review of expense reports, we noted that the CAO's expense report for the item selected in April 2020 was reviewed by the CFO, not the Board of Directors.

Recommendation:
Pre-approval for travel and events is an effective control designed to capture the largest costs being incurred. As a good practice, we recommend that the CAO's expense reports be reviewed and approved by the Board Chair and a policy for the CAO's expense reports be created to reflect this requirement. In addition to a review of the amount of expenses incurred, the focus of this approval is an evaluation of the nature and reasonability of expenses incurred in compliance with District policy. We recognize the current process may achieve more timely reimbursement, and that a practical control may involve addition of Board review after review by the CFO and payment takes place. A preventative control before payment is a stronger control than after payment.

Management Response:
Recommendations on improvements to the existing process is taken under advisement. Management will review and present a recommendation to the Board Chair.

As discussed in prior years, in addition to the requirements of the local government act, the Chief Financial Officer is a designated Chartered Professional Accountant and bound by the professional code of conduct and ethics governed by CPA Canada.

Additionally, 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.

A review of delegated authority, budget authority and disbursement signing authority matrix was completed in 2020. Staff recommend sign off on CAO expenses consistent with KPMG recommendations which require all expense reimbursements to be signed by Board chair. This extends the existing procedure to not only cover travel expenses, but all expense claims.

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

1. **Related Party Transactions with Board of Directors**

   Observation and implication:
   In 2018, the adoption of a new accounting standard resulted in the District requesting Declarations of Related Party Transactions from the Board of Directors covering both pre- and post-election Directors. There were five Directors where the Declaration form was not received. Further, in 2019 there were two Directors where the Declaration form was not received.

   In the absence of a Declaration form, management placed reliance on the Oaths taken by Directors. While the Oaths address Directors not allowing private interest to influence their conduct in public matters, they do not cover any potential transactions with related parties.

   Update from 2020 Audit:
   During our review of the declarations submitted by the Board Directors, it was noted that all Directors submitted the signed declaration forms.

2. **Expense Report Process - Cutoff Policy**

   Observation and implication:
   During our review of Board Member expense reports, we noted an instance where vehicle mileage recorded as an expense and reimbursed in 2017 actually occurred in 2016. Staff Travel Expenses Procedures point G. Claims Procedure states the following: Claims for travel expenses are to be submitted on the CRD Travel Expense Report claim form within 30 days of the period in which the expenses were incurred. Submission of expenditures for reimbursement after the 30-day period particularly at year end increases the risk of cut-off errors and inaccurate expense balances.

   Update from 2020 Audit:
   During our review of Board Member expense reports, we noted no instances where a cutoff error existed.

3. Bank Reconciliation Process – Capital Regional Housing Corporation (CRHC)

Observation and implication:
During our review of the year-end bank reconciliation for CRHC, we observed outstanding cheques aged past 60 days were included as reconciling items, indicating that they were stale-dated. Neither CRD nor CRHC has a policy on stale-dated cheques nothing when to investigate, reissue or write off such items. Continuing to include stale-dated cheques on bank reconciliations can decrease the efficiency of the reconciliation process and results in recipients not relieving CRD's liability to them.

Update from 2020 audit:
During our audit, we performed substantive procedures over the bank reconciliation for the Corporation and noted no issues with cheques aged over 60 days. We noted a standard operating policy has been drafted for stale-dated cheque.

4. Expense Report Process – certification of attendance and accuracy

Observation and implication:
During our review of Board of Directors' expense reports, we noted there are activities and events Directors attend and are compensated for that do not have readily available supporting documentation to verify both the occurrence and type of business expense such as attendance at external meetings, training or conferences that take place outside the District's premises. Where possible, external documentation to verify attendance is preferred to support the dates, duration and accuracy of these costs. It provides a clear documentation trail that the amounts and nature of expenses are in compliance with Board policy. In the absence of such documentation being available, a certification by Directors can serve as alternate support for the accuracy of amounts claimed.

Update from 2020 audit:
During our audit, we did not note any instances where activities and events that Directors attended did not have support available.

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.