

ASSURANCE AND ADVISORY
BUSINESS SERVICES

September 29, 2006



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City of Ottawa

Management Letter

Year ended December 31, 2005

September 29, 2006

PRIVATE AND CONFIDENTIAL

Ms. Marian Simulik
Treasurer
City of Ottawa
110 Laurier Avenue West
Ottawa ON K1P 1J1

Dear Ms. Simulik:

Re: Fiscal 2005 Management Letter

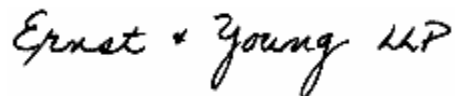
As part of our audit of the financial statements of the City of Ottawa for the fiscal year ended December 31, 2005, we evaluated the City's system of internal controls to the extent we considered necessary under Canadian generally accepted auditing standards. This is done to establish a basis for reliance on systems and determining the nature, timing and extent of other auditing procedures necessary to express an opinion on the City's financial statements. This study was not designed to determine whether the City of Ottawa's system of internal controls is adequate for management's purposes.

Our audit of the financial statements will not necessarily disclose all conditions requiring attention in the system of internal control because both the audit and study employed, as is customary, selected tests of accounting records and related data. However, our audit identified areas where financial management and internal controls could be strengthened. The attached memorandum of observations and recommendations is enclosed for your information and consideration.

The suggestions and comments outlined in the memorandum concern processes and systems and are not intended to reflect in any way upon your personnel.

We would be pleased to discuss this document or to respond to any questions at your convenience.

Sincerely,



André Bussière
Deanna Monaghan

Enclosures

cc. Mr. Wayne Martin, Manager, Accounting and Financial Reporting, City of Ottawa

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Unfunded Liabilities

Observation and Recommendation

At the end of 2005, the City's unfunded liabilities included various accrued employee benefits totalling \$270 million. These liabilities have increased at a rate far in excess of the rate of inflation and they have increased significantly since amalgamation. The City's budget only provides for these costs on a cash basis.

The City should have a clear strategy to limit the future growth of the unfunded liabilities for employee benefits.

Management's Comment

In the past, municipalities in Ontario were not required to expense or disclose significant obligations entered into with current and retired employees. With the implementation of new accounting rules in 2000, these obligations must now be expensed at the time they are earned and the obligation must be reflected as a liability on the City's financial statements. The growing cost of these obligations is a challenge facing all municipalities in Ontario. Management agrees a long term strategy is required and will incorporate this strategy in a subsequent report to council

Provision for Assessment Adjustments

Observation and Recommendation

The City currently does not provide for taxation revenue reductions resulting from successful assessment appeals. We believe that a reasonable historical basis could be established to estimate such adjustments on outstanding appeals at the end of a fiscal period. This would provide a better matching of taxation revenue adjustments with the period to which they relate.

The City should consider establishing assessment adjustment provisions. This should include consultations with other Ontario municipalities who have established such provisions.

Management's Comment

Management disagrees. Assessment appeals present a number of intrinsic difficulties. A number of appeals especially in the commercial, industrial and multi-residential tax classes do not come before the Assessment Review Board until subsequent years (sometimes 3 or more years after the appeal year). The magnitude of the impact on taxation revenue is also quite often unknown in the appeal year. Therefore, reasonableness can only be established on gathering statistical data on an historical basis.

Counters and Supervisors Performing the Counts and Recounts

Observation and Recommendation

During our inventory count observation procedures, we noted that employees performing the counts and recounts had access to the perpetual records. The employees conducting counts and recounts should not have access to perpetual records in order to ensure an objective first and second count. Management should compare count results to system records after the counts have been completed.

Management's Comment

Materials Management has been concerned with this particular question since adopting the Cycle count process in 2003. The need to count approximately 27,000 items in a 7/24 operation while maintaining operations in support of daily service demands precluded highly expensive and in our case, drawn out year-end inventories. There was also the need to involve all staff in ownership of the stock in terms of locations, quantities and security. Cycle counting was adopted as the most effective means of improving inventory control. Last year, as the process developed it enabled us to perform additional recounts of high dollar items.

The weakness in system though has been the possibility that staff would access records and invalidate the process. It is in the 2006 work plan to begin roving audits to confirm counts using support staff. This process has been delayed until mid-year due to staff constraints on the one individual in this area having to carry out audits and at the same time supporting and directing the cycle count process. Materials management will request an FTE position of Supervisor Stores Audit be approved and staffed in future budgets to enlarge this audit capability and provide increased oversight in the control of transit materials.

Accounting for Return of Defective Supplies

Observation and Recommendation

On the tour of the OC Transpo warehouse, it was pointed out that there were numerous items under warranty or available for return and credit located at Boyd's warehouse that had yet to be returned to suppliers.

We recommend that defective or available for credit inventory should be addressed in a timely manner.

Management's Comment

The Fleet Maintenance division within Public Works & Services handles new bus warranty items. The previous manufacturer required that Transit Fleet collect various parts and process in batches. Through consultation with the current manufacturer representative, there is an initiative to decreasing the turnaround time for warranty item returns down to 10 days. For other items solely handled by Materials Management Transit, shipments are collected and processed weekly both in the case of non new bus warranty items and for items which are returned for core credits.

Access to Inventory

Observation and Recommendation

We noted that storerooms are accessible to non-stores personnel. In addition, a number of employees have access to the rear Boyd storage access door, which leads directly to the parking lot.

Access by non-stores personnel should be restricted (unless accompanied by authorized personnel) and the rear Boyd storage access door should have increased physical security.

Management's Comment

Due to space and staff constraints the building in question supports both Fleet Maintenance and Materials Management storage. The amount of work in this building only supports 1 Storekeeper at this time but the workload precludes escort duties for the limited amount of Fleet staff involved in their activities which include forklift dependent tire and internal rebuild core distribution and the control of warranty items. The building design requires access to 2 areas in opposite corners of the building and isolating them would require the loss of much valuable space in creating a dedicated secure aisle in support of their operations.

All doors to the parking lot are controlled electronically, keyed or are dead bolt secure against entrance from the parking lot. Access keys and electronic passes are controlled and issued to Materials staff, Maintenance staff and 2 emergency keys held by Program Managers in Fleet. It is possible to pass materials through one of the fire exit doors but it should be noted that most of the material in question is heavy and used mainly in Transit applications having very little commercial value to other sectors.

Plans are in process to upgrade both the building security and redefine who provides the service out of this building. Funding is available in 2006 to improve the security system that will include both electronic and video components. Three FTE's are also being requested in future budgets to provide the capability to assume control of all materials movement in this building.

Ottawa Public Library Purchases and Receipts of Goods

Observation and Recommendation

During our testing, we found that it was not always clear whether the library materials received were checked for accuracy and compared to the supplier invoice. The Library could potentially be paying for items not received.

Management should ensure that proper evidence of invoice/receiving document review exists. Packing slips should be stapled to the invoice and quantities received (or not received) should be clearly indicated. Discrepancies should be followed up and payments adjusted accordingly.

During our audit, we also noted that Ottawa Public Library (OPL) purchase order prices were not compared to actual invoiced amounts. Once again, OPL could be overpaying for library materials.

OPL processes should include a comparison of purchase order and invoice prices to ensure that what is being invoiced is what was agreed per the purchase order.

Management's Comment

We agree that proper evidence of receipt of goods is required before issuing payment for library materials. Controls are in place to ensure payment is not made until the order is complete. Only approximately 10% of orders arrive with a packing slip. When the orders are unpacked the contents of the box are checked against the packing slip, or in its absence, the invoice to verify receipt of goods. All packing slips are stapled to the invoice. The staff who unpack the order initial either the invoice or the packing slip as a check against the contents of the delivery. Written procedures are in place and all staff have copies. If a discrepancy is discovered the order is put aside and the vendor is immediately contacted. The invoice is not paid until all materials have been properly accounted for.

For the majority of deliveries, library staff verify the invoice price against the purchase order price. However, in some cases it is impossible to determine what the exact price of the item will be. This is because many American catalogues and reviewing journals are used for the selection of material, but the material comes from a Canadian distributor. Usually Canadian distributors apply a discount but it is not a fixed amount and cannot be known in advance. The price on the purchase order is an estimated price, taking into account exchange rates and average discounts. This is standard library practice.

Vacation Accrual for Employees on Long-Term Disability

Observation and Recommendation

We noted that persons on long-term disability are still accruing vacation benefits when the collective agreements specify that they are only entitled to 15 months of vacation accrual after going on disability.

SAP should be configured to properly accrue the vacation entitlements for persons that are on long-term disability.

Management's Comment

System problems that have been identified with respect to vacation accruals are being addressed. The error relates to the actual accrual calculation and is manually corrected at time of payment. At no time were employees incorrectly paid. A plan is in place to correct overstated vacation accruals for the 2006 year end.

Employee Vacation Carry-Over

Observation and Recommendation

We noted that several employees carried large vacation banks far in excess of the allowable carry-over allowed in the collective agreements.

As per our discussion with management, employees can carry over more than the amount allowable in the collective agreement in instances where there are work related situations and deadlines that preclude them from taking vacation. However, some employees have up to one full year of vacation carry over, which appears excessive. If these people were to take this vacation all at one time they would have to be replaced and the City would have to pay someone else to fill their position. This would be costly and lead to possible staffing shortages.

The City of Ottawa should implement a program to reduce the vacation carry over balance. Management should enforce the carry over policies as per the collective agreement.

Management's Comment

Employees are generally entitled to carry over one year's vacation entitlement into the following year under their terms and conditions of employment. Some of the vacation banks are the result of the work performed during the early years of amalgamation. In 2005, Senior Management established a comprehensive work planning calendar to facilitate work planning. This calendar recognizes key vacation periods (mid-July to mid-August and the last two weeks of December) which encourages and facilitates employees taking vacation. Managers will be reminded to encourage employees to utilize their vacation leave in the year it is earned and will be asked to monitor balances in accordance with the carry over provisions in the relevant collective agreement.

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