



KPMG LLP
Chartered Accountants
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada

Telephone (604) 691-3000
Telefax (604) 691-3031
www.kpmg.ca

PRIVATE & CONFIDENTIAL

Mr. Jim Bruce
Finance & Corporate Services Administrator
The City of Richmond
6911 No. 3 Road
Richmond BC V6Y 2C1

June 24, 2003

Dear Mr. Bruce

We have audited the financial statements of the City of Richmond ("the City"), as of and for the year ended December 31, 2002 and have issued our audit report thereon dated March 22, 2003. In planning and performing our audit of the City's financial statements, we considered the City's internal control over financial reporting in order to determine the nature, extent and timing of our auditing procedures for the purpose of expressing our opinion on the financial statements. A financial statement audit does not include examining the effectiveness of internal control and does not provide assurance on internal control.

The maintenance of adequate controls designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time, may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

Our consideration of internal control over financial reporting in our audit of the financial statements would not necessarily disclose all internal control matters that might be weaknesses under assurance standards established by the Canadian Institute of Chartered. A weakness in internal control is a deficiency in the design or effective operation of internal control. A weakness in internal control is significant if the deficiency is such that a material misstatement is not likely to be prevented or detected in the financial statements being audited. During our audit of the financial statements upon which we reported on March 22, 2003 we noted certain matters involving the design or operating effectiveness of internal control over financial reporting that we are bringing to your attention and to offer our comments and recommendations.

We believe that our comments are, by their nature, control weaknesses which warrant the attention of management.

These internal control weaknesses were considered in determining the nature, extent and timing of the audit tests applied in our audit of the financial statements as at and for the year ended December 31, 2002 and this letter does not affect our audit report on these financial statements dated March 22, 2003. We have not considered internal control over financial reporting since the date of our audit report.





Mr. Jim Bruce
The City of Richmond
June 24, 2003
Page 2

Our recommendations are presented in the attached appendices. In Appendix I we have discussed new matters that have arisen this year. In Appendix II we have brought forward points from our 2001 letter, which have been satisfactorily rectified.

All the matters identified in these appendices have been discussed with the appropriate members of management.

This letter is a by-product of the financial statement audit and is therefore a derivative communication. This letter has been prepared solely for the use of management in discharging their responsibilities with respect to the financial statements and is not intended for any other purposes. This letter should not be distributed to others outside the entity without our prior written consent. We disclaim any liability to any third party who may rely upon this letter

Very truly yours

KPMG LLP
Vancouver, Canada

cc: George Duncan, Chief Administrative Officer
Office of the Mayor

NEW MATTERS ARISING FROM THE 2002 AUDIT

INFORMATION TECHNOLOGY

1) Segregation in PeopleSoft profiles

One of the key controls in the payroll process is the segregation of duties between Human Resources and Payroll, in particular, segregation between preparation of the payroll, and maintenance of employee master data, such as pay groups. During KPMG's test of controls and per discussion with the Information Technology department, it was determined that this segregation is not enforced within the system.

Recommendation

The City should adopt guidelines over job roles and how they are reflected in PeopleSoft. At present changes are approved by the business owner, but the impact on internal controls does not appear to be fully considered.

It is recommended that management consider developing role matrices which define the access rights appropriate to job roles. Changes within the matrixes can be processed routinely, but changes which contradict the role matrixes would require further approval.

Management's Response

To ensure that there is complete segregation of duties between the Human Resources (HR) functions and the Payroll functions, the Information Technology (IT) department will:

- i) restrict the security function to the IT department and to no more than two persons.
- ii) provide HR and Payroll personnel appropriate access according to job roles.
- iii) document access rights available to HR and Payroll personnel.
- iv) ensure that all requests for new users are approved at the Manager level.
- (iv) ensure that changes that cross over job roles and updating of history are approved at the Director level.

CASH AND TREASURY

2) Community Association Trust

In 2001, the City began holding cash balances, in trust, on behalf of various Community Associations. The purpose was to allow the City to make investments and earn investment income for the Associations. During 2002, the investment transactions for the Community Associations were not tracked correctly in the general ledger. As a result, cash and investments held in trust on behalf of the Community Associations did not reconcile to the liability balance.

Although this error was corrected during the audit and the investments held in trust for the Community Associations are not included in the financial statements of the City and are only disclosed in the notes to the financial statements, the City should ensure such information is tracked properly.

Recommendation

The City should ensure all investment transactions for the Community Associations are properly tracked and reflected in the financial statements. Monthly investment reconciliations should be prepared and reviewed by management.

Management's Response

The investments for the Community Associations are now pooled in with the City investments and are therefore tracked in the investment and offsetting liability accounts. Consequently, the investment transactions will be properly reflected in the financial statements.

In addition, the Community Associations investment portfolios will be reconciled and reviewed on a monthly basis and statements will be issued on a quarterly basis.

3) Management review of bank reconciliations

One of the City's controls related to the revenue collection process is management's review of monthly bank reconciliations. During the 2002 audit, KPMG reviewed a sample of bank reconciliations and noted that none of them were authorized by the manager in charge of the review, Gavin Julius (Manager, Treasury). KPMG reviewed the sample of bank reconciliations and noted no significant issues with regards to reasonability and accuracy of computation. However, review of monthly bank reconciliations is a key control in ensuring reconciling items in the bank reconciliation are reasonable, and if not, are followed-up in a timely manner.

Recommendation

The City should ensure monthly bank reconciliations are reviewed by appropriate management and properly signed off as evidence of such review.

Management's Response

Effective immediately we will ensure that the monthly bank reconciliations are reviewed by the appropriate management staff and properly signed off as per your recommendation.

4) Reconciliation of accounts receivable sub-ledger

During the 2002 audit, KPMG became aware of and discussed with management a software issue in Peoplesoft's receivable subledger that caused a number of entries to be duplicated, causing

receivable and revenue balances to be overstated. The total overstatement for fiscal 2002 was immaterial to adjust.

Recommendation

The accounts receivable subledger should be reconciled to the general ledger on a monthly basis and all reconciling items should be appropriately adjusted.

Management's Response

Effective immediately we will implement a monthly reconciliation process for the accounts receivable subledger as per your recommendation.

**MATTERS CARRIED FORWARD FROM 2001
THAT HAVE BEEN RECTIFIED IN 2002**

CASH AND TREASURY

1) Investment management

At December 31, 2001, the City held investments totaling \$199 million. The return on the City's portfolio for the year ended December 31, 2001 was 4.4% compared to 5.7 % in 2000. As a comparison, the MFA benchmark that is often referred to is the SCM T-Bill Index which was 5.89% for 2001.

One reason for the lower rate of return is the timing of investment purchases and sales which do not appear to be properly matched to the cash needs of the City. In the period from January 25, 2001 through February 23, 2001 investments totaling \$43 million were sold prior to reaching full maturity. As a result, the amount of income earned for the period the investments were actually held was reduced by a total of \$1.8 million. In other words, the rate of return earned on these investments was reduced because they were sold before reaching full maturity. Also, during the same period, investments of approximately \$20 million were made, usually at rates of return that were lower than what would have been earned if the investments cashed in early were held to maturity. It should be noted that in no case was there any loss of original amounts invested.

Recommendation from 2001

The City must forecast its cash needs and position for the year and match the investment activities and maturities to this forecast in order to maximize the investment return realized on cash resources.

Management Response in 2001

The YTD return on the City's portfolio of 4.4% compared to 5.7 % in 2000 is a result of the inclusion of the total discount of various sales of investments prior to their maturity.

The sale and redemption of the investments were entered into to:

- a. Introduce additional liquidity into the portfolio by purchasing investments with a shorter maturity period, hence the lower rates of return.
- b. Meet payment for unexpected late invoices
- c. Deal with the cash flow inefficiencies resulting from the transition in changing banking accounts from Royal Bank to Scotiabank. The City was obligated to continue funding the Royal Bank banking accounts for a period of six months for all cheques which had been issued prior to the change over.

We concur that there were inefficiencies in the cash flow during this period of January and February 2001. These inefficiencies have subsequently been corrected. A revised cash flow has been completed and implemented.

Status in 2002

Management advised us that the City forecasted its cash needs and position for the year and matched the investment activities and maturities to this forecast in order to maximize the investment return realized on cash resources.

2) Cheques received by mail

Mail is sorted by mailroom personnel who then allocate the mail to various departments (i.e. Business & Licenses, etc.). The departments match the cheques to an invoice and forwards the package to the Accounts Receivable department. The Accounts Receivable department ensures the cheque and the invoice match and then forwards the receipts to the cashier for entry.

Recommendation from 2001

Since cheques are handled by staff who also have access to the accounting records, there is the potential for misappropriation of funds. To mitigate this, the City needs to ensure that all write-offs of receivables are authorized by the appropriate persons.

Management Response in 2001

Accounts Receivable staff have limited access to the Accounts Receivable and Billing Module of the financial system. This security and access allows only one staff member to perform billings, another staff member to apply the payments and another staff member to perform the maintenance. Cheques are forwarded to the Accounts Receivable staff so that the correct allocations can be performed when no supporting documentation is attached. There is an independent reconciliation of the Receivable Cash Clearing general ledger account performed by the Supervisor to ensure that all cheques are allocated correctly. It is the City's current policy to ensure that all write-offs of receivables are authorized by authorized signatories only. This is further supported by the reconciliation performed on the Bad Debt general ledger account.

Status in 2002

Management appears to have implemented sufficient controls (reconciliation of the bad debt account, segregation of duties between bad debt write off and cash handling function) to mitigate the risk of lack of segregation of cash handling and record keeping functions.

LONG-TERM DEBT**3) Retirement of long-term debt**

The City of Richmond currently has a significantly greater amount of liquid investments than their debt with the Municipal Finance Authority ("MFA"). In addition, the investments earned a significantly lower average rate of return than the average cost of debt in 2001.

Recommendation in 2001

While we understand that the City may be locked in with respect to the MFA debentures, the City may wish to review whether sinking fund contributions could be increased to reduce the net debt.

Management Response in 2001

The City's Long Term Debt is established by Bylaws and entered into with the Municipal Finance Authority. During July 2000, an analysis was undertaken to assess the cost of retiring selected high interest rate debt issues. Our findings indicated:

- The penalties that would be paid would be onerous.
- The terms and conditions of the financing require some of the issues to be refinanced during 2002. This would result in lower financing costs.

Based on these findings, the Finance Select Committee agreed not to retire any of the long term debt.

Status in 2002

The City will continue to reassess costs and benefits of retiring the long term debt early. However, the Finance Select Committee agreed not to retire any of the long term debt as at December 31, 2002.

INFORMATION TECHNOLOGY

4) Disaster recovery planning

The City has developed a formal plan to recover its information systems in the event of certain types of disasters, but the plan has not been fully tested. Also, the plan addresses recovery of the City's information systems, but it does not address continuity/recovery of the City's critical business processes. Meanwhile, a proposal to revise the City's overall disaster recovery plan, of which IT is one component, has been submitted to Council. As the City becomes more dependent upon information technology, the need for a fully tested disaster recovery plan becomes increasingly important. However, critical City services must continue to operate while and after IT systems are restored in the event of a disaster. Therefore, it is important that the City's disaster recovery plan address not only the IT systems, but also continuity of key business processes. Without a fully integrated and tested recovery/contingency plan, which includes core business processes and related support processes such as IT, the City may experience significant downtime and incur financial losses in the event of a disaster.

The City has put forward a Budget request to secure funds to retain a consultant to further assist the city to properly formalize a plan. KPMG was requested in 2002 to provide input to this, although no formalized project has been undertaken yet due to the funding request.

Recommendation from 2001

The City should increase its efforts to obtain the funding required to continue the development of the disaster recovery plan since this plan is significant to the continued operations of the City.

Management response from 2001

The City has recently obtained funding for this project and will make the disaster recovery plan a high priority.

Status in 2002

A project was initiated during the year to address the need for a City-wide business continuity plan. The first key element of this was the development of a business impact analysis (BIA) which defines the recovery tolerances and prioritised requirements of the City. This was done for business units defined as critical by TAG. KPMG was engaged to provide periodic status checks on the project and at the time of our audit the project was on track.

The BIA is currently awaiting approval and will form the basis of the next phase, which will include an analysis of current capability against the BIA requirements, and projects to address any gaps identified.

Based on the progress achieved to date, and the commitment by the City to completing the Business Continuity project, the audit implications of this issue have now been resolved.

Management response from 2002

The City will continue its commitment and efforts with the business continuity project, including the completion of the next phase of the business impact analysis and the development, implementation and maintenance of the business continuity plan.

5) Termination procedures

Historically the City did not have a formal procedure to ensure timely removal of employee computer privileges upon termination. The City has now developed a draft termination checklist designed to ensure that the Information Systems department is informed of all employee terminations, and removes related computer access on a timely basis. We understand Human Resources is reviewing this checklist which will be updated to reflect the current environment.

Recommendation from 2001

We recommend that this new policy be formally approved and endorsed by senior management, and implemented as soon as possible. The City should consider similar procedures to review systems privileges and data access when employees change positions, roles and responsibilities. All accounts that exist for users who are no longer employed by the City should be made inactive in PeopleSoft.

Management response for 2001

All users that are no longer employed by the City are immediately denied access to the network. This effectively ensures that they cannot access any system City-wide. As per the recommendation we will ensure that these accounts are also simultaneously inactivated in Peoplesoft.

Status in 2002

No terminated employees were noted as active in the system.

ACCOUNTS PAYABLE**6) Authorization of Corporate Visa Card Expenses**

The City has issued more than 400 Visa cards to staff for various purchases including airfare, hotel, and meals. As part of our audit, we examined Visa purchase reports on a test basis to ensure that the charges had been properly authorized and that receipts had been attached. None of the reports we examined were signed by the department supervisor and in some instances no receipts were attached. This poses a risk in that staff could use the cards for personal use.

Recommendation from 2001

All expense reports should be signed off by the cardholder and reviewed and authorized by the department supervisor, who should also ensure that appropriate receipts are attached.

Management response from 2001

We recently cut-over the City's purchase card program from Visa to Mastercard as we get more versatility with web based reporting and achieve better vendor enabling capabilities. As part of the transition we ensured that all controls were tightened as evidenced by the extensive manual we prepared for each cardholder and the classroom training provided to each department administrator. In addition, each cardholder was asked to sign a compliance statement prior to receiving their new purchase card accepting full responsibility. As a result, failure to adhere to the requirements in the manual could result in loss of card privileges, disciplinary action and in some extreme cases even termination. We believe that this deterrent effect will help us attain full compliance with regards to the submission of receipts. As far as signoff by department supervisors is concerned we have also taken the transition opportunity to reinforce this audit requirement with all parties concerned and expect compliance to improve considerably as a result.

Status in 2002

The sample of expense reports that we reviewed were correctly signed off by the cardholder and reviewed and authorized by the department supervisor, who also ensured that appropriate receipts were attached. If receipts were missing, a "Receipt Missing Form" was attached.

PAYROLL**7) Manual payroll cheque controls**

Most of the City's payroll disbursements are automated by the PeopleSoft Human Resource Information System. Each pay period, the City also prints some "manual" payroll cheques to satisfy various employee requests. However, the City's PeopleSoft Payroll system does not print an electronic cheque number on these "manual" cheques. When the bank scans the cheques, the cheque numbers do not appear on the bank statement. Without cheque numbers, bank reconciliations are more difficult and time-consuming, and there is an increased risk of fraud or error.

Recommendation from 2001

We recommend that the City address this control weakness as soon as possible by modifying the PeopleSoft system to print the cheque number in both human and machine-readable form on each cheque.

Management response for 2001

In June 2002, the system was modified to print electronic cheque numbers on the cheques as per the recommendation.

Status in 2002

The system has now been configured to print cheque numbers. Additionally, a cheque printer has been installed in the Payroll department.