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PRIVATE & CONFIDENTIAL

Mr. Andrew Nazareth
Director of Finance
The City of Richmond
6911 No. 3 Road
Richmond BC V6Y 2C1

April 2, 2004

Dear Mr. Nazareth

We have audited the financial statements of the City of Richmond (the "City") as of and for the year ended December 31, 2003, and have issued our audit report thereon dated April 2, 2004. 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 the inherent limitations in internal control in any organization, and the cost/benefit relationship of eliminating all possibilities of fraud, 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 Accountants. 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 April 2, 2004, we noted some matters involving the design or operating effectiveness of internal control over financial reporting or other performance improvement opportunities that we are bringing to your attention and to offer our comments and recommendation. These comments, by nature, only highlight the control weaknesses we identified during our audit and do not address the strengths in internal control at the City.





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These internal control weaknesses and performance improvement opportunities 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, 2003, and this letter does not affect our audit report on these financial statements dated April 2, 2004. We have not considered internal control over financial reporting since the date of our audit report. The matters identified 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 and Council in discharging their responsibilities with respect to the financial statements and is not intended for any other purposes. We disclaim any liability to any third party who may rely upon this letter.

Our comments are segregated into two categories. In Appendix I, we discuss matters which arose during the 2003 audit. In Appendix II, we provide an update on matters which we discussed in connection with the 2002 audit.

We would like to express our appreciation for the co-operation we received from you and your staff during our audit visits. If you wish to discuss any of these matters with us or wish assistance in implementing them, please contact us.

Very truly yours

KPMG LLP
Vancouver, Canada

cc: George Duncan, Chief Administrative Officer
Rod Kray, General Manager of Finance & Corporate Services
Malcolm Brodie, Mayor

MATTERS ARISING FROM THE 2003 AUDIT**1. Adoption of a formal fraud strategy and response plan****Observation**

Over the past few years, the City has made changes to their system of internal controls as a result of our management letters. During the current and prior year's audits we have performed additional procedures, as now required under Generally Accepted Auditing Standards, to determine the City's fraud risk factors and the general fraud prevention and response frameworks. Due to recent events and developments in public market places, formal fraud strategies and response plans are now required for public companies and are considered best practices in the public sector.

An anti-fraud and irregularity strategy and response plan is designed to reduce the possibility of fraud by formalizing the roles and responsibilities of Council, management and staff. Such a strategy would include information on:

- the framework established by the City for the prevention of fraud and other irregularities;
- the respective roles and responsibilities of Council, senior management and members of staff;
- the arrangements and protection of staff who report on suspected fraud, irregularity or other malpractice; and
- actions to be taken following allegations of fraud, including the role of senior management.

A formal strategy and response plan decreases the risk of fraud, theft of City assets or other irregularities. Without a specific response plan in place, staff may be reluctant to report inappropriate activities or may take inappropriate steps themselves in dealing with suspected cases of fraud. As a result alleged cases may remain unreported or be compromised by being incorrectly investigated.

Recommendation

The City should review their fraud strategy and response plan to ensure it encompasses the elements of best practices in the public market place.

Management's comments

We have always worked toward establishing the highest standards of internal controls possible to prevent fraud and other irregularities and we believe we have been successful with this regard. As well, we have not been made aware of the contrary based on KPMG's tests and procedures conducted while engaged by the City. We understand that the incidents that have occurred in the public markets have heightened the awareness of fraud and the need for internal controls. Consequently, we will formalize the internal control practices that are already in place into a plan that is consistent with best practices in the public market place.

2. Short and long term strategic plan

Observation

During our review, we noted that no short or long term Information Technology (IT) Strategic Plan has been developed. The current planning horizon is based on dealing with IT issues as and when they occur.

Implication

Effective long and short term IT strategic planning is essential for the City to ensure that its information resources will support established business goals and objectives. Effective planning improves productivity by:

- Helping ensure the best possible use of resources, personnel, machines, materials facilities, capital and time,
- Integrating all aspects of a program into an efficient, unified effort,
- Providing a measure for evaluating performance and improving productivity, and
- Preparing for future risks and contingencies.

Recommendation

We recommend that the City develop a written three to five year strategic IT plan that is based on the City's long term business plan/objectives. This plan should be a working document that addresses the direction of such key issues as:

- Hardware requirements,
- Systems software requirements,
- Communications,
- Application development,
- Budgeting,
- Emergency procedures and contingency plans, and
- Review of relationships with outside vendors.

Management's comments

We have budget plans, IT equipment plans, software plans and contingency plans that align with the City's vision, mission and values. In addition, IT has also developed goals, initiatives and strategies for a number of years. As a result of the recommendation, we will now consolidate all of the above mentioned plans into one comprehensive IT strategic plan.

3. Segregation of duties in PeopleSoft

Observation

The following lack of segregation of incompatible duties weaknesses were noted within PeopleSoft Financials and HRMS;

- Members of the Application Systems team have access to update the 'SALARY_GRADE_TABLES' within PeopleSoft HRMS thereby allowing them to alter salary rates.
- Members of the Application Systems team have access to update the 'PERSONAL_DATA ' table within PeopleSoft HRMS thereby allowing them to create and maintain employee data
- Accounts Payable and Accounts Receivable have the ability to update and maintain vendor information.

Implication

These weaknesses in the internal control environment and access segregation could result in intentional or unintentional unauthorized transactions being performed within PeopleSoft and result in the need for further less efficient detective controls.

Recommendation

KPMG recommends that:

- The City perform an evaluation of access control with an emphasis on ensuring appropriate segregation is applied.
- IT be removed from update access for all HR information. If access to these tables is required to allow troubleshooting this should be set up on an as needed basis but should be removed as soon as the issue is resolved.
- Accounts Payable and Accounts Receivable personnel should not be able to maintain and create vendors. Only Purchasing and Inventory should be able to control this information. Inquiry access should only be enabled for both Accounts Payable and Accounts Receivable.

Management's comments

- Each year, we evaluate Peoplesoft security access controls for each department to ensure that there is proper segregation and appropriate controls in place.
- IT staff have been limited to inquiry access for all HR information. Access to update these tables will be set up if needed for troubleshooting purposes as recommended and will be removed once the issue is resolved.
- Each cheque issued by the Peoplesoft system requires the establishment of a vendor record. This includes program refunds, tax refunds and other payments which do not require the involvement of the Purchasing department or the use of a purchase order. To ensure that vendors are appropriately set-up, the Accounts Payable Supervisor who is

independent of the set-up, reviews and approves all additions and changes to the vendor table. It is neither feasible nor practical for Purchasing staff to do the vendor set up as our operations will be negatively impacted resulting in major delays and complaints. The Purchasing department does establish the vendors in Peoplesoft for purchases involving a purchase order as per the Purchasing policy. The same applies to the Accounts Receivable department who need to process refunds for deposits on accounts or security deposits. These additions and changes are approved by the Accounts Receivable Supervisor who is independent of the set-up.

4. Commercial Water Meter Reading Process

Observation

KPMG observed that there were a number of control weaknesses inherent within the Neptune software used for the commercial water meter reading process. In addition to these weak IT environment controls there is the possibility of errors within the system. The following weaknesses were noted:

- No logical access controls i.e. login Ids, password, segregation of duties
- No change management controls including no separate test environment
- No completeness and accuracy checks to ensure that all data has been captured and is accurate when transferred between Neptune and Open Tax
- No checking of manual updates to the meter information

Implication

The lack of control totals and check sums could allow incomplete, inaccurate meter readings to be processed in error affecting the reputation and financial resources of City.

Without adequate change control and acceptance testing data could be compromised, lost or deleted causing damage to both the system, information and the reputation of the City of Richmond.

Recommendation

The City should seek to gain additional functionality around the Neptune system to ensure that it meets basic control and audit requirements. In addition to this, logical access and change control procedures should be put in place for the Neptune system. This should include the installation of a simple test environment and the adoption of formal change control procedures to ensure that no unauthorized change is made to the software and internal control environment.

All manual changes to the data within the remote meter reader or 'guns' by the water meter department should be checked to ensure that there is a valid reason code attached. The water meter manager should monitor and follow up on changes.

Management's Comments

The possible 'software control weakness' noted above is isolated to the one stand alone machine in the Meter shop and that relates to the Commercial meter reading only (see below). The Residential meter reading is performed by an independent third party. Information from the third party is sent directly to our IT Department for uploading. There are numerous verification processes in place to ensure that the information is accurate and not tampered with. Therefore, the integrity of the Residential meter process is intact.

With regards to the Commercial meter program there are compensating integrity controls that check for reasonableness when IT uploads the data into the billing system. The controls will check for reasonableness based on average prior consumption, logic, correct beginning/ending dates and so on. When the upload is completed, an error report is generated and returned to the Meter shop for verification. Data will not be uploaded for those accounts identified with possible errors. In turn, the Meter shop sends someone on the road to investigate the possible error. Once that is done, the updated information is passed back to IT and the system goes through all the reasonableness checks again before the information reaches the billing system.

A separate test environment for the Neptune system has been set up on another desktop in the Meter Shop. In addition, IT will work with the Meter Shop to produce a custom report of manual updates to the meter information that will require signoff by the Manager of the Water Department.

UPDATE ON RECOMMENDATIONS MADE IN 2002**a) Adoption of Post-Employment Benefits, Compensated Absences and Termination Benefits**

In 2002, we recommended that the City review the requirements of Public Section Accounting Handbook ("PSAB") Section 3255, *Post-employment Benefits, Compensated Absences and Termination Benefits*. The Handbook Section provides recommendations regarding recognition, measurement and disclosure requirements of obligations for post-employment benefits, compensated absences and termination benefits earned by employees and expected to be provided to them when they are no longer providing active service either on a temporary or permanent basis.

The City will be required to adopt Section 3255 recommendations for fiscal 2004. The adoption of this policy will be considered a change in accounting policy and will be applied retroactively to the financial statements.

In 2003, the City engaged actuaries to perform a valuation on the liability that the City will be required to record in order to be compliant with PSAB Section 3255. Based on our discussions with the City's management, the City does not foresee any problems with being fully compliant with PSAB Section 3255 for 2004.

b) Community Association Trust

In 2002, we recommended that the City implement procedures to track investment transactions for the Community Associations in the general ledger. In 2002, cash and investments held in trust on behalf of the Community Associations were not reconciled to the liability balance. For accounting purposes, these trusts are disclosed in the notes to the financial statements, but are not recorded in the statement of financial position of the City.

In 2003, the City has adopted a policy whereby Community Association accounts are reconciled on a quarterly basis.

c) Management review of bank reconciliations

In 2002, we recommended that the City ensure all bank reconciliation be reviewed in a timely basis, as this is a critical control in ensuring that transactions have been appropriately recorded in the City's financial records.

Based on our procedures performed in 2003, bank reconciliations are being reviewed on a timely basis by the appropriate finance manager.

d) Reconciliation of accounts receivable sub-ledger

In 2002, we identified a software issue in Peoplesoft's receivable sub-ledger that caused a number of entries to be duplicated. We recommended that the accounts receivable sub-ledger be reconciled to the general ledger on a monthly basis.

Based on our procedures performed in 2003, the receivable sub-ledger is now being reconciled to the general ledger on a monthly basis.