



# City of Markham

## Report of the Auditor General Development Charges Audit



**Presented to:** General Committee of Council, City of Markham

**Date:** September 4, 2018

# AGENDA

- Background
- Audit Objective
- Audit Approach
- Scope
- Strengths
- Observations and Recommendations
- Acknowledgement

## BACKGROUND

Development charges are assessed against all new development and re-development within the City in accordance with the Act, to recover the growth-related capital costs associated with providing infrastructure and facilities to service new development. As per the Act, development charge background studies are required to be conducted in order to form direction in the by-laws.

In December 2017, Council approved the City's Development Charges Background Study update, and new by-laws went into effect December 13, 2017. The City collects development charges and remits amounts as per the by-laws to fund capital projects undertaken by the Region of York, York Catholic District School Board and York Region District School Board.

## AUDIT OBJECTIVE

The objective of the audit was to evaluate the processes and controls in place over the issuance, collection, and remittance of development charges, identify strengths and/or weaknesses, and provide recommendations for improvement.

## AUDIT APPROACH

### 1. Planning

- Define objective and scope.
- Confirm project duration and schedule.
- Assign team members and develop team structure.
- Describe deliverables.
- Create Audit Planning Memo.



### 2. Execution

- Obtain existing process descriptions and documentation.
- Conduct interviews / discussions.
- Develop audit work plan and audit procedures.
- Understand and evaluate current state by performing tests and assessing processes and controls in place.



### 3. Reporting

- Identify improvement opportunities.
- Prepare draft report with observations and recommendations.
- Validate and present recommendations.
- Issue final report.

## SCOPE

The scope of the audit concentrated on development charges incurred by the City, covering the period from January 1, 2018 to May 31, 2018. Specifically, the scope of the audit focused on the following:

- Obtaining and understanding policies, procedures, processes and existing controls through interviews of key personnel in the Finance Services and Building Standards Departments;
- Reviewing sample documentation related to the City's issuance of development charges, including:
  - Invoices and statements issued and the alignment of development charges with the City's by-laws;
  - Granting of development charge credits, exemptions or reductions;
  - Payments from developers;
  - Remittance of payments to the school boards and regional municipality; and,
  - Subdivision, site plan, capital project documents, development agreements and permits to verify applicable development charges.
- Reviewing the development charges reconciliation and reporting processes and controls; and,
- Reviewing Development Charge Reserves accounts, including processes and controls for reserve fund usage, borrowing, and reconciliation.

## OUTSIDE OF SCOPE

- Assessment of the results of the development charge background studies;
- Determination of development charge rates;
- Processes related to the establishment of subdivision, site plans, capital project documents and development agreements; and,
- Information technology general controls (“ITGCs”) within development charges systems and databases.

## Audit Observations – Strengths:

### Development Charges Assessment

Permit application files such as site drawings, are put together by the Building Services Department and reviewed by the Development Finance Team (“DFT”), where applicable, before the DFT begins their assessment of the applicable development charges.

In addition, key information, such as development charge rates, types, and area specific boundaries from both municipal, regional, and school board by-laws, is extracted and regularly updated into a single table for ease of reference to be used by the DFT when performing assessment of development charges.



## Strengths Continued:

### **Development Charges Issuance and Collection**

Applicants must make payment for their development charges before their building permit can be issued.

### **Development Charge Remittance**

A tracking schedule detailing all development charges collected during the month is regularly updated by the DFT. Subsequently, a monthly reconciliation is prepared of individual balances in the development charge schedule, summary of collections, and wire payment report.

## CONCLUSION

### Observation Rating Scale

Rating	Rating Description
<b>L = Low</b>	The observation is not critical but should be addressed in the longer term to either improve internal controls or efficiency of the process (i.e. 6 to 12 months).
<b>M = Medium</b>	The observation should be addressed in the short to intermediate term to either improve internal controls or efficiency of the process (i.e. 3 to 6 months).
<b>H = High</b>	The observation should be given immediate attention due to the existence of either a potentially significant internal control weakness or operational improvement opportunity (i.e. 0 to 3 months).

- Overall 1 **Medium** and 1 **Low** priority observations were identified.

## OBSERVATION #1:

### Development Charge Reserves Borrowing Interest Rate

The City has two policies which address reserves and interest rates:

- Development Charge Borrowing Policy; and,
- Investment Interest Allocation Policy.

The Development Charge Borrowing Policy, 2015 states:

*"Internal Borrowing Interest Rate - The internal borrowing rate will be based on the York Region debenture rate for a similar term as the internal borrowing is estimated to be required."*

The Investment Interest Allocation Policy, 2015 states:

*"Interest Bearing Reserves and Reserve Funds - Interest is calculated and allocated monthly. The amount of interest is determined by applying the average money market rate earned by the City in a given month to the previous month's ending reserve balance. Any reserves or reserve funds with negative balances will be charged at a rate of prime."*

## OBSERVATION #1 CONTINUED:

MEDIUM

### Development Charge Reserves Borrowing Interest Rate

As detailed in the 2018 First Quarter Investment Performance Review, an interest rate of 3.45% was applied to the approved \$20M internal borrowing to the Development Charge Reserves from the General Portfolio. The interest rate of 3.45% is the prime rate at the time of borrowing (February 22, 2018), which is appropriate given that some components of the Development Charge Reserve were in a negative balance at the time of borrowing. However, the prime rate differs from the York Region debenture rate, which is the interest rate listed in the Development Charge Borrowing Policy.

## OBSERVATION #1 CONTINUED:

MEDIUM

### Auditor General Recommendations

The City should update the Development Charge Borrowing Policy to ensure consistency with the Investment Interest Allocation Policy and reflect current practice.

## OBSERVATION #1 CONTINUED:

### Management Response

Management supports the Auditor General's recommendation.

Staff's practice is to charge the prime rate when development charge borrowing is deemed to be short-term and the York Region debenture rate when borrowing is deemed to be long-term.

To date, all development charge borrowing has been deemed short-term and therefore the prime rate as per the Investment Interest Allocation Policy has been charged.

As of August 1, 2018, there is no development charge borrowing.

The 2018 Investment Performance Review Report will include a recommendation to edit the Development Charge Borrowing Policy to reflect current practice.

**Timeline to implement: Q1 2019**

## OBSERVATION #2:

### Presentation of Development Charge Borrowing Balance

On a quarterly basis, City staff present the balance of internal borrowing between the Development Charge Reserves and the General Portfolio to General Committee of Council, as required by the Development Charge Borrowing Policy.

Upon review of the 2018 First Quarter Investment Performance Review – Exhibit 3: Investment Terms, presented to General Committee, \$20M borrowed on February 22, 2018 is combined with \$20M borrowed on January 6, 2016 to show a single balance of \$40M with one borrowing term and one transaction date. Individual internal borrowing transactions for the Development Charge Reserves are not itemized, but rather summed into a single balance.

## OBSERVATION #2 CONTINUED:

LOW

### Auditor General Recommendations

The City should include a footnote that clarifies that the single balance representing Development Charge Reserves lending is comprised of multiple transactions, when applicable, for full transparency and details of the City's internal borrowing to Council.



## OBSERVATION #2 CONTINUED:

LOW

### Management Response

Management supports the Auditor General's recommendation.

**Timeline to implement: Q4 2018**

## OVERALL RECOMMENDATION

The Auditor General recommends that:

- 1) The Development Charges Audit Presentation be received.

## ACKNOWLEDGEMENT

MNP extends our appreciation to the staff and management of the City for their co-operation and assistance throughout the engagement.

