



## City of Markham Development Charges Audit

September 4, 2018

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September 4, 2018

Mayor and Members of Council,

Pursuant to MNP LLP's appointment to provide Auditor General Services, I am pleased to present the Development Charges audit report ("report") of the Auditor General for the City of Markham ("the City"). To ensure the results of our audit are balanced, we have provided in this report a summary of identified strengths as well as observations and recommendations for improvement.

The audit work was substantially completed on June 29, 2018. The report was discussed with the City's management, who have reviewed the report and provided their responses within. This report is provided to you for information and approval of the City's proposed action plans.

Based on the results of our audit, the City has sufficient and effective processes and controls in place over the issuance, collection, and remittance of development charges. Noted areas of strength include having documented and defined processes, multiple levels of documentation review, and reconciliation of development charge collections and remittance.

Opportunities for improvement were also identified with respect to consistency between the City's Development Charge Borrowing Policy and Investment Interest Allocation Policy and the presentation of development charge borrowing balances to Council.

The report will be posted on the City's website and made available to the public after tabling to Council.

Sincerely,

A handwritten signature in black ink, appearing to read 'Geoff Rodrigues'.

Geoff Rodrigues, CPA, CA, CIA, CRMA, ORMP

Auditor General, City of Markham

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## EXECUTIVE SUMMARY

The City of Markham (“City”) assesses development charges against all new development within the City in accordance with the Development Charges Act, 1997 (“Act”) to recover the growth-related capital costs associated with providing infrastructure and facilities to service the new development. The City has enacted a number of by-laws to enforce the application, collection and remittance of all development charges. 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.

As Auditor General for the City, MNP LLP (“MNP”) conducted an audit to evaluate the processes and controls in place over the issuance, collection, and remittance of development charges focusing on the following sub-processes:

- Assessment;
- Collection;
- Remittance;
- Use of Charges for Capital Expenditures;
- Reserve Reconciliation; and,
- Borrowing;

Based on the audit, the City has effective and sufficient processes and controls in place over the issuance, collection, and remittance of development charges. Many of the key controls assessed have evidence to demonstrate operating effectiveness. Noted areas of strength include:

- Ensuring that all supporting documentation is collected by the Building Services Department and kept on file before beginning the assessment of development charges.
- Key information from both Municipal and Regional by-laws is extracted and regularly updated into a single table by the Development Finance Team for ease of reference when performing assessment of development charges.
- Applicants must make development charge payments before their building permits can be issued.
- Regular updates are made to a tracking schedule detailing all development charges collected during the month.
- Monthly reconciliation between development charges collected and the portion remitted to York Region and school boards.

The audit also identified some opportunities to strengthen internal controls in the following areas:

- The guidance regarding interest rates for internal borrowing in the Development Charge Borrowing Policy is not reflective of actual practice.
- Internal borrowing amounts identified in Quarterly Investment Performance Review reports are not itemized to provide details of individual borrowing amounts, borrowing date, and borrow terms.

This report may not disclose all our findings, as minor items that in the Auditor General’s opinion do not rise to the level of reporting to Council, may have been detected and resolved directly with Management.

## BACKGROUND

Development charges are assessed against all new development and re-development (residential and non-residential lands, buildings or structures) 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. The City has enacted a number of by-laws to enforce the application, collection and remittance of all development charges.

As per the Act, development charge background studies are required to be conducted in order to form direction in the by-laws. Such background studies provide the basis of determination of the quantum of the development charges based upon expected growth and capital projects. The by-laws include direction on hard and soft development charge amounts, and Development Charge Reserves. In December 2017, Council approved the City's Development Charges Background Study update, and new by-laws went into effect December 13, 2017. These by-laws include:

- By-law 2017-116 – City-Wide Hard Services Development Charges
- By-law 2017-117 – City-Wide Soft Services Development Charges
- By-laws 2017-118 to 2017-136 (inclusive) – Area Specific Development Charges

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.

As part of its mandate, and in accordance with the approved four-year audit plan, the Auditor General conducted an evaluation of the processes and controls related to development charges at the City.

The City's development charge processes and procedures can be summarized into five sub-processes, which are described below:

**Assessment:** The Building Standards Department verifies key information in the permit applications (i.e. square footage and map zones) before development charges can be assessed by the Development Finance Team ("DFT").

The DFT ensures that all supporting documentation for the permit application is saved within the City's enterprise platform system, AMANDA. The DFT then calculates development charges applicable to the permit application, populates the data into AMANDA, and an invoice is generated. The Financial Analyst emails the invoice to the permit applicant and records the information in the general ledger of the City's financial system, Cayenta.

**Collection:** Once an applicant makes payment for their development charge invoice, the Financial Analyst, receives an automated payment notification email, which allows for AMANDA to issue the permit. Payment information is recorded in the general ledger of Cayenta.

**Remittance:** On a monthly basis, development charge portions collected on behalf of the Region of York, York Catholic District School Board and York Region District School Board are remitted via wire payment to the Region and school boards. The Financial Analyst maintains a schedule detailing development charges collected during the month. A monthly reconciliation is prepared for individual balances in the development charge schedule, collections amounts, and the proposed payment to the Region and school boards.

The Manager reviews the monthly reconciliation for accuracy and completeness. The Treasurer performs an additional review of the reconciliation and approves the payment before it is remitted to the Region and the school boards.

**Use of Charges for Capital Expenditures:** Capital projects are approved by Council as part of the Annual Budget process. Some capital projects include development charge funding and upon Council approval, Finance funds applicable development charge projects.

The Senior Manager, Financial Planning and the Manager, Development Finance review and approve requests for use of funds from the Development Charges Reserve. All supporting documentation is disclosed in the DFT's monthly reporting package when the Financial Analyst processes the journal entries.

**Reserve Reconciliation:** The Financial Analyst prepares a monthly Development Charges Continuity Statement. This statement is prepared using accounting balances from Cayenta, such as cash, revenue, accounts receivable, accounts payable, expenditures, and interest. As part of accounting month end procedures, the Financial Analyst reconciles these accounting balances, against detailed transaction reports to ensure completeness and accuracy of the balances. The Manager reviews the reconciliation for completeness and accuracy.

The final balances of the Development Charges Continuity Statement are summarized into a monthly report, which is reviewed by Senior Management to assess development charge activity and determine if internal/external borrowing is required.

In addition to the development charge processes and procedures, the City has the option to borrow funds for the Development Charge Reserves. Internal and external borrowing for Development Charge Reserves is governed by the City's Development Charge Borrowing Policy. There are regular discussions between management in the Financial Services Department regarding the monthly Development Charges Continuity Statement and the potential need to borrow funds. Once a decision has been made to borrow, the Senior Manager of Financial Strategy and Investments initiates and executes the transaction.

## 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.

## 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.

The following areas were not within the scope of this audit:

- 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.

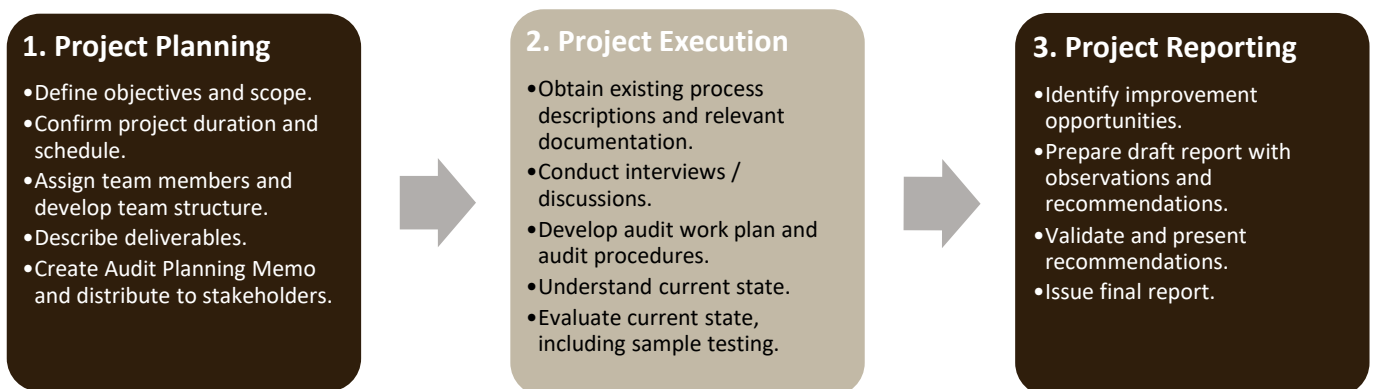
## RISKS

The following inherent risks were considered during the audit, which given the scope of the audit are typical risks to be considered:

- Internal controls are not in place and/or are not effective in ensuring that development charges are properly approved and charged to developers;
- Development charge amounts are not in accordance with by-laws and applicable policies, leading to inaccurate amounts being charged to developers, collected by the City and remitted to other parties;
- Development charges are not appropriately recorded in the financial system, leading to inaccurate and incomplete charges issued to developers, and affect the balances in accounts such as remittance payable, accounts receivable, revenue, and reserves;
- Development charges are not remitted to school boards and the regional municipality in a timely manner, leading to inefficient use of funding for capital projects;
- Withdrawals from the Development Charge Reserves are used for capital projects that are not approved, leading to deviation from the Council-approved annual budget;
- Guidance provided by the Development Charge Borrowing Policy is not followed; and,
- Withdrawals from and additions to the Development Charge Reserves are not reconciled on a regular basis, leading to inaccurate calculation of the reserve balance.

## APPROACH

Based on MNP methodology, the high-level work plan for the audit included the following:



## AUDIT TEAM

The audit was carried out by the following MNP team:

<b>Geoff Rodrigues, Audit Lead Partner</b>	Provided expertise in audit methodology, directed the MNP team in all stages of the audit, and ensured that firm and professional quality assurance standards are maintained.
<b>Jason Burgess, Subject Matter Expert</b>	Provided expert knowledge on development charges during the entire audit process including planning, execution, and reporting.
<b>Veronica Bila, Audit Manager</b>	Managed the audit and reviewed audit results.
<b>Chris Wu, Senior Auditor</b>	Planned and carried out the audit procedures, involving the above resources as needed.

## STRENGTHS

In conducting the audit, MNP noted several strengths with respect to the City's processes and controls in place over the issuance, collection, and remittance of development charges. The following key strengths are described below:

### **Development Charges Assessment**

Permit application files such as site drawings, are put together by the Building Services Department and reviewed by the 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.

### **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.



## SUMMARY OF OBSERVATIONS

To enable the City to set priorities in their action plans, we have reported our observations in one of three categories, “Low”, “Medium” or “High” based on our assessment of the priority (i.e. significance, complexity, and resources required) of each observation.

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

The table below provides a summary of our observations and recommendations, based on the rating scale outlined above. Detailed observations and recommendations can be found in **Appendix A**.

REF.	SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS	RATING		
		L	M	H
1	<p><b>Development Charge Reserves Borrowing Interest Rate</b></p> <p>The City’s two policies which address reserves and interest rates are the Development Charge Borrowing Policy and the Investment Interest Allocation Policy.</p> <p>An interest rate of 3.45% was applied to the approved \$20M internal borrowing to the Development Charge Reserves from the General Investment Portfolio which is appropriate given that some components of the Development Charge Reserve were in a negative balance at the time of borrowing. However, this interest rate is the prime rate and differs from the York Region debenture rate, which was the interest rate as per the Development Charge Borrowing Policy.</p> <p>The City should update the Development Charge Borrowing Policy to ensure consistency to the Investment Interest Allocation Policy and to reflect current practice.</p>			
2	<p><b>Presentation of Development Charge Borrowing Balance</b></p> <p>On a quarterly basis, City staff present the balance of internal borrowing between the Development Charge Reserves and the General Investment Portfolio to General Committee of Council, as required by the Development Charge Borrowing Policy. However, the balance is presented as a single amount and not itemized to disclose each borrowed balance. 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.</p>			

## **RECOMMENDATIONS**

The Auditor General recommends that:

1. The Development Charges Audit Report be received; and,
2. City staff be authorized and directed to do all things necessary to give effect to the recommendations.

## **ACKNOWLEDGMENTS**

We would like to express our appreciation for the cooperation and efforts made by City staff whose contributions assisted in ensuring a successful engagement. City staff provided the Auditor General with unrestricted access to all activities, records, systems, and staff necessary to conduct this audit freely and objectively.

## APPENDIX A: DETAILED OBSERVATIONS AND RECOMMENDATIONS

#	Observation	Rating	Recommendation	Management Response
<b>1</b>	<p><b>Development Charge Reserve Borrowing Interest Rate</b></p> <p>The City has two policies which address reserves and interest rates:</p> <ul style="list-style-type: none"> <li>• Development Charge Borrowing Policy; and,</li> <li>• Investment Interest Allocation Policy.</li> </ul> <p>The Development Charge Borrowing Policy, 2015, states:</p> <p><i>"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."</i></p> <p>The Investment Interest Allocation Policy, 2015 states:</p> <p><i>"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."</i></p> <p>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</p>	<b>Medium</b>	<p>The City should update the Development Charge Borrowing Policy to ensure consistency with the Investment Interest Allocation Policy and reflect current practice.</p>	<p>Management supports the Auditor General's recommendation.</p> <p>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.</p> <p>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.</p> <p>As of August 1, 2018, there is no development charge borrowing.</p> <p>The 2018 Investment Performance Review Report will include a recommendation to edit the Development Charge Borrowing Policy to reflect current practice.</p> <p><b>Timeline to implement: Q1 2019</b></p>

#	Observation	Rating	Recommendation	Management Response
	<p>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.</p>			
2	<p><b>Presentation of Development Charge Borrowing Balance</b></p> <p>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.</p> <p>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.</p>	Low	<p>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.</p>	<p>Management supports the Auditor General's recommendation.</p> <p><b>Timeline to implement: Q4 2018</b></p>



## ABOUT MNP

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