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**Item No. 2**  
**Audit & Finance Committee**  
**January 15, 2016**

**TO:** Councillor Bill Karsten, Chair, and Members of the Audit & Finance Committee  
Original Signed

**SUBMITTED BY:** \_\_\_\_\_  
John Traves, Acting Chief Administrative Officer

**DATE:** December 21, 2015

**SUBJECT:** Supplementary Report - Update Internal Control Process Review

### INFORMATION REPORT

#### ORIGIN

On October 21, 2015 in a report to Audit & Finance Committee, staff reported weaknesses that had been identified in the internal controls for the administration of security deposits. This is an update on the process review.

#### LEGISLATIVE AUTHORITY

- Section 48(2) of the *Halifax Regional Municipality Charter*:

##### **Audit committee**

48 (2) The responsibilities of the audit committee include:

- (b) an evaluation of internal control systems and any management letter with the Auditor;

- Section 4 (d) of the Audit and Finance Standing Committee Terms of Reference:

(d) ensure the adequacy and effectiveness of the systems of internal control in relation to financial controls and risk management as established by Administration;

#### BACKGROUND

Internal Controls are defined as the combination of people, policies and procedures that management rely upon to ensure they are:

1. Operating effectively and efficiently and safeguarding the assets;
2. Providing reliable information to those that need it; and
3. Complying with all applicable constraints.

As reported to Audit & Finance on October 21<sup>st</sup>, (see Attachment A), staff had identified weaknesses in the internal control process for security deposits held by Planning & Development. Since first identifying

this issue, staff has been reviewing the internal controls and processes for security deposits in Planning & Development as well as researching leading practices. Staff has also expanded the scope of this internal control process review to look at all HRM Business Units who take security deposits and the supporting internal controls and business processes.

**DISCUSSION**

**Security Deposits accepted by business units**

**Planning and Development Security Deposits**

The review of all security instruments held (not deposited) by Planning & Development are summarized below in Table 1:

**TABLE 1:**

<b>SECURITY INSTRUMENT</b>	<b>#</b>	<b>\$\$ AMOUNT</b>	<b>AVAILABLE FOR DEPOSIT</b>	<b>\$\$ AMOUNT</b>
Letters of Credit	17	\$1,373,915	6	\$380,479
Certified Cheques	277	\$2,954,327	146	\$2,001,369
Cheques	33	\$189,785	0	\$0
Money Orders	22	\$132,737	17	\$122,858
Cash	2	\$2,900	2	\$2,900
<b>Total Cashable Security</b>	<b>334</b>	<b>\$3,279,749</b>	<b>165</b>	<b>\$2,127,127</b>

Of the security instruments used, only cashable security (certified cheques, cheques, money orders and cash) can be deposited to HRM's bank account when received. Letters of Credit (LOC) are a document issued by a bank guaranteeing that a payee will receive payment in full as long as the terms and conditions of the project are met. LOC are typically held in secure area such as a safe or secure filing room, documented, catalogued and are cashed only if provisions of the contract have not been met. Once the project is complete and the security is no longer required, the LOC is released back to the issuing bank. Of the 17 LOC currently in Planning & Developments custody, only 6 are active totalling \$380,479. LOC typically have an expiry date that need to be monitored as a project may run over its projected time line, necessitating action to have the security extended.

Total cashable securities are \$3,279,749. However, all of the cheques are stale dated, and many of the certified cheques and money orders are older than 10 years, which would mean HRM would have to make an application to the Bank of Canada if the security were required to be cashed. The projects that these deposits relate to are very likely to be completed and the cheques can be returned pending review of the development file or inspection. **Total cashable securities available for deposit are 165, totalling \$2,127,127.**

There were 2 security deposits held in cash, one for \$300 and one for \$2,600, totalling \$2,900. These monies were deposited immediately by Finance once identified. Holding cash in a development file is a violation of internal controls as it increases the risk of fraud and unnecessarily exposes employees to suspicion of fraud and possible investigation if the cash should go missing.

After reviewing all security instruments per table 1, Planning & Development have estimated that:

- 30% of deposits can be released back to the developer
- 30% require further action and inspection
- 40% are active projects/permits/developments

To date, 67 cashable securities of the 165 available for deposit have been deposited to HRM's bank totalling \$1,337,314.81.

#### Real Estate Division Security Deposits

The Real Estate Division advise they take the following deposits:

- 10% deposit for purchase of industrial park lots
- Generally 5% deposit for purchase of general real estate
- Landscape security deposit for industrial lot site improvements, released following completion of landscaping by purchaser

Deposits are not held and are forwarded to Finance for processing and deposit. Any LOC related to Real Estate are administered and currently held in the custody of Legal Services.

#### Fire Services Security Deposits

HRM Fire Services takes refundable security burning permits, under By-law O-109, Respecting Open Air Burning. The permit fee is \$10,000, and can be in the form of certified cheque, LOC, or Bond Surety. Presently, Fire Services are not holding any security deposit instruments, and that overall do not take many security deposits. A security in the form of a certified cheque was being held, and was determined to be missing. Fire Services staff actioned this issue by advising their client to file a Bond of Indemnity.

#### Procurement Division Security Deposits

Procurement disclosed that they were holding 52 certified security deposits in the amount of \$1.2M. **All security has been deposited.** From an internal control perspective, holding cheques was not a best practice, however, the deposits were well managed, documented, and filed in a secure location.

Procurement also holds performance security in the form of LOC, and Surety Bonding. These instruments were also well managed, documented, and filed in a secure location.

Upon review of security deposit handling in other Business Units, Finance will be implementing a standard practice and taking a lead role with respect to security deposit administration and custody of LOC and Bond Sureties.

#### Best Practices and Policies

##### Best Practices and Process for the Administration of Cashable Security Deposits

The issuer of a certified cheque may file a bond of indemnity with the issuing bank at any time. This action effectively cancels the certified cheque. As a result of this review, Finance is able to conclude that with the exception of approximately \$8,000, there is a high probability that the stale dated certified cheques have been cancelled using bonds of indemnity. As noted throughout this report, this is a business process issue and does not represent lost revenue to HRM. There would have been an impact on working capital however as HRM does not borrow short term funds, interest costs have not been incurred.

Under the direction of the CAO and CFO, Finance staff has been tasked with the assignment of designing internal controls and processes that are considered industry "best practices" for administering developer and other security deposits.

The best practice for handling cashable deposits is to record the transaction at the time the deposit is made (point-of-sale) in the corporate cashing system (Hansen), and for subsequent and same day deposit to HRM's bank. Once the cheque is cashed and clears through the bank, the security solely remains with HRM. This process is also very important as the deposited security will act as a control to ensure the work is inspected by HRM and meets HRM standards.

Functionality already available in Hansen Permitting for managing and administering security deposits will be used to electronically record and store details on the deposit and enable reporting functionality that did not exist before. Benefits of the new reporting will enable Planning and Development to report on the amount of non-refunded deposits, and security deposits related to a permit.

### **Best Practices and Process for the Administration of Letters of Credit (LOC) & Bond Sureties**

Currently LOC and Bond Sureties are stored in the development, real estate and procurement files, and are not catalogued or monitored for expiry. The new and improved process will have all original LOC and Bond Sureties under the custody of Finance. Finance has secure storage filing facilities that meet the safeguarding of assets principle. Finance will also catalogue and index the LOC and track and report on expiry dates. When the LOC is no longer required as security, finance will release the LOC or Bond Surety back to the issuing bank or Bonding Agency.

Next steps in this assignment are to formally document the new business processes. Corporate Planning will assign a Business Analyst to complete the process documentation.

### **Business Process Documentation & Corporate Cash Management Policy**

As the new business processes are implemented, the processes will be fully documented for the business unit. It has been stated in this report that the control issues surrounding security deposits can be mitigated with the establishment of best cash management practices and expectations. These practices and expectations should be published in a Corporate Cash Management Policy.

A cash management system should include:

- **Documentation.** Fully documented cash management procedures and policy.
- **Communication.** Effective cash management involves all business units and departments and is co-ordinated by Finance. This includes clear expectations to business units that handle deposits and prepare cash management activities.
- **Control.** Controls as well as roles and responsibilities are instrumental to safeguarding assets.
- **Continuous Monitoring.** Regular review of policies and business processes.

Finance has drafted a Corporate Cash Management Policy that will provide guiding policy and principles of cash management to the organization, especially non-financial business units. As part of the internal control assignment, Finance will be recommending the Cash Management Policy for executive review and CAO approval. The cash management department from the Revenue division will be the owners of this policy and responsible to ensure corporate compliance.

### **FINANCIAL IMPLICATIONS**

From a revenue perspective security deposits would only have a financial implication if it becomes necessary for the security to be acted on due to non-compliance of a contract. There have been no

instances to date where a deposit has been identified to be accounted for as a revenue recovery. In terms of the improved processes to date, cashable deposit securities totalling \$3.3M for Planning & Development and Procurement have been deposited into HRM's bank account. These deposits will be accounted for as "cash" (asset), and "refundable security deposits" (liability) on our balance sheet.

**COMMUNITY ENGAGEMENT**

None required.

**ATTACHMENTS**

Attachment A – Internal Control Process Review Report dated October 21, 2015

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A copy of this report can be obtained online at <http://www.halifax.ca/commcoun/index.php> then choose the appropriate Community Council and meeting date, or by contacting the Office of the Municipal Clerk at 902.490.4210, or Fax 902.490.4208.

Report Prepared by: Jerry Blackwood, Manager of Revenue, Treasurer 902.490.6470

Louis de Montbrun, Manager of Financial Reporting 902.476.0585

Original Signed

Report Approved by:

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Amanda Whitewood, Director of Finance & ICT/CFO 902.490.6308

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P.O. Box 1749  
Halifax, Nova Scotia  
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Attachment A  
Audit and Finance Standing Committee  
October 21, 2015

TO: Chair and Members of the Audit and Finance Standing Committee

Original Signed

SUBMITTED BY:

Richard Butts, Chief Administrative Officer

DATE: October 14, 2015

SUBJECT: Internal Control Process Review

INFORMATION REPORT

ORIGIN

Staff has identified weaknesses in the internal controls surrounding the development deposit process and is providing information to the Audit and Finance Standing Committee of the issues and the improvements planned to resolve this issue.

LEGISLATIVE AUTHORITY

- Section 48(2) of the *Halifax Regional Municipality Charter*.

**Audit committee**

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BACKGROUND

Planning and Development requires developers to provide security to ensure that they meet all of their responsibilities under various by-laws related to the development process. The security from the developers may be in the form of cheque, certified cheque and/or letter of credit.

In the process of closing a long term file on July 2, 2015, Planning and Development attempted to deposit a group of certified cheques as a developer had not met their responsibilities. As the certified cheques were stale dated, the cheques did not clear and Planning and Development were advised of same on July 23, 2015. This event triggered a review, which has identified a weakness in the internal controls\* surrounding the holding and recording of this security.

\* Internal controls are the combination of people, policies, and procedures that management rely upon to ensure they are:

1. Operating effectively and efficiently and safeguarding the assets;
2. Providing reliable information to those that need it; and,
3. Complying with all applicable constraints.

While we believe the risk of fraud is low, it is a reality in all business process and is one of the reasons for continuing to examine and strengthen internal controls.

\*A certified cheque is a form of cheque for which the bank verifies that sufficient funds exist in the account to cover the check, and so certifies, at the time the check is written. Those funds are then set aside in the bank's internal account until the draft is cashed or returned by the payee.

Certification therefore is a direct promise of a bank to pay, independent of a customer's obligation to pay.

A certified cheque stale dated however, after 10 years, the process to get the funds changes as the bank can no longer honour the cheque directly. The funds are placed with the Bank of Canada and we would have to collect through the Bank of Canada.

**COMMUNITY ENGAGEMENT**

None required.

**ATTACHMENTS**

None.

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Report Prepared by: Louis de Montbrun, Manager, Financial Reporting 902.476.0585  
Jerry Blackwood, Manager, Revenue 902.490.6470

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Report and Financial Approved by: Amanda Whitewood, Director Finance & ICT/CFO 902.490.6308

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