Office of the Auditor General

Audit of Lansdowne Accounting/Waterfall

Tabled at Audit Committee
November 24, 2020

Visit us online:

www.ottawa.ca/en/city-hall/accountability-and-transparency/office-auditor-general

The **Fraud and Waste Hotline** is a confidential and anonymous service that allows City of Ottawa employees and members of the general public to report suspected or witnessed cases of fraud or waste 24 hours a day, seven days a week.

www.ottawa.fraudwaste-fraudeabus.ca / **1-866-959-9309**

Table of Contents

Executive summary 1
Detailed audit report 12
- Introduction 12
- Purpose 12
- Background and context 12
- Audit findings and recommendations 15

Appendix 1 – List of acronyms, abbreviations and terms 58
Appendix 2 – List of related parties 60
Appendix 3 – Recommendations and management responses 61
Appendix 4 – About the audit 69
Acknowledgement 73

Executive summary

Introduction

The Audit of Lansdowne Accounting/Waterfall was included in the 2019 work plan of the Office of the Auditor General (OAG) approved by City Council.

To provide clarity and avoid any confusion within this report, the Lansdowne Master General Partnership (LMGP) will be referred to as LMGP/OSEG and any references to Ottawa Sports Entertainment Group will be identified by the acronym OSEG.

Purpose

The Audit of Lansdowne Accounting/Waterfall assessed whether the City's internal accounting processes for the Waterfall agreement between the City of Ottawa (City) and Ottawa Sports and Entertainment Group (OSEG) are designed and operating effectively and that all components of the City's equity contributions or return on equity are accurately recorded in the Waterfall Distribution System (Waterfall) in accordance with the Master Limited Partnership Agreement.

Background and rationale

In October 2012, the City entered into an agreement to form a Public Private Partnership (P3) with OSEG to transform Lansdowne Park[1].

The Lansdowne Partnership Plan (LPP) is based on a 30-year closed financial system that captures contributions (i.e. equity) and capital costs and cash flows from operations. Net cashflows from the closed system are to be distributed to the City and OSEG based on a waterfall of priorities as set out in the Master Limited Partnership Agreement, which expires on December 31, 2044. At that time, the responsibility for the stadium and parking structure will be transferred back to the City.

The Waterfall consists of six (6) levels of distribution that represent the order in which positive cash flows will be distributed. Distributions cannot be made until the previous level's distribution requirements have been fulfilled (i.e. Distributions to Level 2, OSEG Return on Equity, cannot be made until all required Level 1, Additions to the Lifecycle

[1] Master Limited Partnership Agreement, October 2012

Fund, distributions have been completed). The Table below outlines the six (6) levels. Where the City and OSEG are represented in the same level, positive cash flows are distributed equally to each partner.

Table 1: Lansdowne Master Limited Partnership Waterfall Distribution Structure

Level	Description	Definition
1	Additions to the Lifecycle Fund	Distributions made to the Lifecycle Fund to be used to maintain the assets (e.g. Retail, Stadium and Parking components).
2	OSEG Return on Equity	Distributions to OSEG for interest earned/accrued on their Equity contributions at a rate of 8% per year on a cumulative basis.
	City of Ottawa Return on Funding Equity	Distributions to the City for interest earned/accrued on the City's Funding Equity (i.e. $0) at a rate of 8% per year on a cumulative basis.
3	OSEG Return of Additional Equity	Distributions to OSEG for the return of Additional Equity.
4	OSEG Return of Equity	Distributions to OSEG for the return of their Minimum Equity (i.e. $30M).
	City of Ottawa Return of Equity	Distributions to the City for the return of its Funding Equity (i.e. $0).
5	City of Ottawa Return on Deemed Equity	Distributions to the City for interest earned/accrued on the City's Deemed Equity Contributions at a rate of 8% per year on a cumulative basis. City Deemed Equity is equal to the Retail Value (i.e. value of the retail component lands).
6	OSEG Residual Share	The balance of the available Net Cash Flow from the Total Project, excluding the Urban Park, will be distributed to OSEG and the City in equal shares.
	City of Ottawa Residual Share	

As part of the LPP, in order to limit the legal liability of the City and OSEG, the Lansdowne Master Limited Partnership (LMLP) was created in which the City and OSEG are equal limited partners and the Lansdowne Master GP Inc. (LMGP) is the general partner. LMLP owns 99.99% of each of the Component Limited Partnerships (i.e. Lansdowne Stadium Limited Partnership (LSLP), Lansdowne Retail Limited Partnership (LRLP), Ottawa 67's Limited Partnership and Ottawa RedBlacks Limited

Partnership. Each subsidiary is also managed and operated by a General Partner. The Limited Partnerships were formed under the laws of the Province of Manitoba, where the City and OSEG, as Limited Partners, are afforded greater limited liability protection. The following diagram shows the legal and ownership structure of the Lansdowne Master Limited Partnership.

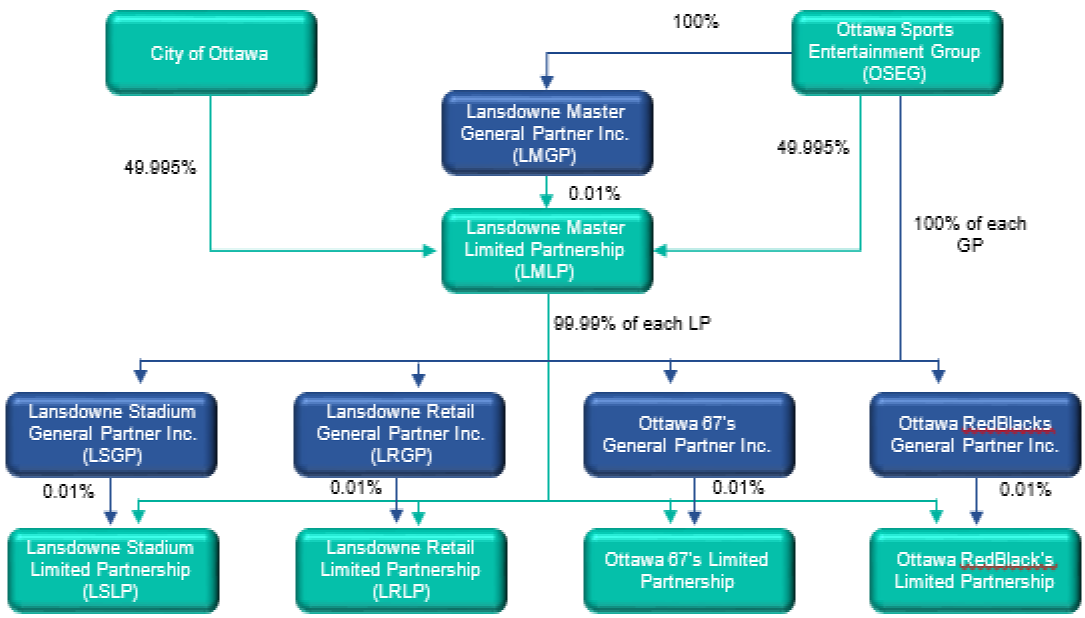

Figure 1: Lansdowne Master Limited Partnership Legal Structure

While OSEG and the City have equal interests in the LMLP, their respective returns from the partnership are provided through the Waterfall. The relative priorities set out in the waterfall system are the product of negotiations between the City and OSEG and were intended to produce balance between contributions made to the LPP and responsibilities assumed. Both OSEG and the City have been committed to the ongoing operations of LMLP as per the agreement and as a partnership – collaborating, resolving disputes and making joint decisions to ensure both partners mutually benefit.

Findings

The Audit focused on five (5) key objectives. The key findings related to each Audit Objective are summarized below:

Audit objective 1: Business planning, risk management and performance measurement and reporting:

It was found that the City has in place a process to monitor the Business Planning activities of the LMLP, through the review of annually updated Pro Forma Financial Statements, that a Risk Register has been developed to monitor the City's perceived risks and that the Performance Measurement and Reporting processes are demonstrated through detailed annual reporting of recent performance to senior management and Council.

While the City provided evidence to support each of these processes, it was found that opportunities exist to improve on the overall effectiveness of these activities. Improving the effectiveness of the City's monitoring process will help the City manage their risks more effectively and ensure that the Waterfall Distribution System accurately reflects the City's forecasted return on investment (ROI).

Audit objective 2: City accounting of equity and return on equity:

We found that the City's assessment of their equity position in LMLP against the Public Sector Accounting Standards (PSAS) was thorough and complete. The City's Financial Statement Auditors confirmed that the City's accounting of their equity position in LMLP is properly represented in the City's Financial Statements.

Audit objective 3: OSEG's accounting for their share of equity and return on equity:

Based on the rigorous audit procedures performed, it is our opinion that there is an overstatement of OSEG's Additional Equity Account in the amount of $6.5M. In other words, OSEG continued to earn/accrue interest, at a rate of 8% per annum, on the $6.5M extra in the Additional Equity Account. This translates to OSEG earning/accruing additional interest above what was agreed to in the settlement approved by Council, in the Return on Equity Account at a rate of $520,000 per year (i.e. $6.5M x 8%) or potentially $14M over the remainder of the life the partnership.

This overstatement was created in 2015 when OSEG did not follow the structure of the settlement agreement, but instead only transferred $17.0M from the Additional Equity Account (Interest bearing at 8%) and the remaining $6.5M from the Return on Equity Account (non-interest bearing) to a Commercial Loan secured by the City when Council approved a $23.5M settlement for the repair of the steel corrosion in the roof of TD Place. The settlement permitted OSEG to transfer $23.5M from the Additional Equity Account to a Commercial Loan, secured by the City[2]. Although there is currently no cash outflow consequence to this error, this remains uncorrected in the waterfall forecasts. The longer the errors remain uncorrected, the higher the risk that documentation and support for accuracy is unavailable.

Based on one interpretation of Sections 4.2 and 4.3 of the Master Partnership Agreement, it was also found that interest on OSEG's Minimum Equity for the years 2012 and 2013 were overstated by a total of $944,022 (i.e. $314,674 in 2012 and $629,348 in 2013). This error remains uncorrected.

Upon reconciling the Net Cash Flow calculations, which are a key input for the Waterfall, we found that the method used to calculate Net Cash Flows by OSEG is in accordance with the agreements. However, it was not possible to assess whether the amounts were classified correctly based on the documentation provided. Some minor variances in the Net Cash Flow amounts were found upon conducting a reconciliation exercise between the Audited Consolidated Financial Statements and the Waterfall system which would have a minimal impact on the net cashflow calculation.

Any discrepancies in calculations and reported numbers could be areas of concern for the City, as these calculations could result in subsequent distributions being misallocated. Misallocations could have a trickle-down effect and could impact future distributions and interest calculations (i.e. Return on Equity) for the City within the Waterfall.

Audit objective 4: City monitoring and oversight of Waterfall Distribution System:

We found that the City has established processes and controls to actively monitor interest calculations and distributions. However, the City has only completed one (1) detailed analysis of the Waterfall since operations began in 2014 (Specified procedures

[2] Finance and Economic Development Committee Meeting, December 1st, 2015

completed by a third-party accounting firm in April 2020), which illustrates some limitations in the City's oversight and monitoring practices.

While this process does ensure the City is aware and monitoring the reported financial results and proposed budgets, it was found that the City is not directly involved in the annual approval process relating to the contribution of Additional Equity by OSEG although there is no requirement to do so in the agreement.

Given the City's limited involvement in the approval process, our findings in relation to Audit Objective 3 and the materiality of the Waterfall balances relating to OSEG's Additional Equity (i.e. $96.76M current, $105.26M forecasted) and Return on Additional Equity (i.e. $23.29M Accrued to Date, $238.83M forecasted), it is important for the City's Monitoring and Oversight Processes to be comprehensive to ensure that the Waterfall fairly represents the projected returns on investment for both partners. Unnecessary or misallocated contributions to OSEG's Additional Equity Account have a significant impact on the long-term forecasts for OSEG's Return on Additional Equity. Both of these categories of equity are higher ranked (i.e. Level 3 and Level 2 respectively) in the Waterfall Distribution Structure than the City's first opportunity to receive returns on their equity (i.e. Level 5).

Audit objective 5: City monitoring of non-arm's length[3], revenue and expense transactions:

The City has implemented a process for a general review of the non-arm's length transactions as part of the year-end review process, however this verification is a high-level reasonability check of year-over-year changes in the Related Parties' amounts. A detailed transactional level analysis was started in 2018 and performed by a third-party accounting firm as part of a Specified Procedures engagement of the 2012-2017 waterfall calculations. This engagement resulting in no material findings. The scope of this audit covered the period from 2012-2019 and given the overlapping years, we focused the majority of our analysis on non-arm's length transactions that occurred during the 2018-2019 period. While the specified procedures engagement only looked at expenditures greater than $1M, our sampling methodology did not include a minimum dollar amount. Given the direct impact that these transactions have on cash flows and

[3] Non-arm's Length Transactions are transactions between two (2) or more entities where the entities have a mutual interest and/or may mutually benefit from a business transaction. As such, the business entities may not/cannot act independently.

the waterfall distribution system (i.e. the City's Return on Investment), a detailed analysis should be done at a minimum every three (3) years to ensure appropriate monitoring and oversight is performed.

We found no material variances in the dollar amounts of the non-arm's length transactions tested. However, the validity of these transactions could not be assessed for 62% (e.g. 8/13) of transactions, valued at $10,987,534.33, due to limitations and gaps in the supporting documentation made available to the auditors.

There is a lack of formal guidance with respect to the treatment of non-arm's length transactions and OSEG's tendency to exclude detailed descriptions for entries in their financial system amplifies the challenges relating to clearly understanding and reconciling the non-arm's length transactions. Given the volume and materiality of the non-arm's length transactions and their potential impact on cash flows, it is important for the City to ensure that these transactions are being managed and reported upon fairly and accurately in LMLP's financial systems and that they are reviewed annually.

Conclusion

Although it was found that the City has established some processes to actively monitor and validate financial results, calculations of interest, OSEG's additions to equity and distributions of equity, some opportunities for improvement were identified. Our findings relating to OSEG's recordkeeping and Waterfall Distribution reporting activities further highlight the need for increased levels of examination and analysis in the City's monitoring and validation practices.

The partnership has a multitude of extensive and complex agreements, which outlines how the partnership should be operated and governed, while also protecting the partners' interests and limiting exposure to liability. Although these agreements and the partnership structure protect the City from significant liability risks (i.e. protection from creditors), the City is nonetheless faced with certain risks relating to their obligations under the agreements, financial performance and stability and ultimate dissolution of the partnership. More robust monitoring and validation processes would help reduce City risks relating to satisfying their contractual obligations under the LPP agreement(s) and help to ensure that the City's forecasted returns are accurately reported in the Waterfall and to Council.

In the current environment (i.e. the Retail and Restaurant Industry crippled by COVID-19 restrictions, the 2020 CFL season cancelled, the remainder of 2019-2020 OHL season cancelled, the status of 2020-2021 season unclear and fan attendance unknown), LMLP's revenue forecasts could be dramatically impacted for the foreseeable future. If these revised forecasts project significant negative cash flows, there is a risk that OSEG may be unwilling or unable to meet their contractual obligations of contributing the required equity to address negative cash flows and sustain operations. In this event, the partnership could be dissolved and all of the responsibility for the operations and maintenance of the City's assets (i.e. Stadium, Parking Garage and Retail) would revert back to the City. The current operating and maintenance costs for these facilities are significantly greater than the $3.8M in operating costs that the City had been paying prior to the LMLP and is avoiding through the LPP agreement. Consequently, this could result in an unexpected funding pressure for the City (i.e. before the planned end to the Partnership in 2044).

The following recommendations have been made to assist the City with establishing more robust monitoring and validation processes to provide the City with an increased level of visibility and understanding of LMLP's ongoing operations and financial performance and their immediate and long-term impacts on the City's forecasted return on equity and their operational responsibilities relating to the Stadium, Parking Garage and Retail space.

Recommendations

In order to address the various findings identified above, we propose that the City implement the following recommendations to enhance their current processes and practices and address areas of risk and gaps found during this Audit.

Audit objective 1: Business planning, risk management and performance measurement and reporting:

It is recommended that the City enhance and optimize their annual and quarterly financial results review and monitoring processes to include the following:

- Increase the level of detail in the City's annual analyses to a level sufficient to identify and assess material variance at the account level and that they work with OSEG to include notes in the pro forma financial forecasts and Waterfall Schedule indicating the basis of allocation and assumptions used in the forecast. This would also ensure that Council is provided with a greater level of detail and assurance on the reported pro forma financial forecasts and the associated medium and long-term outlooks.

- The validation that key sections, within the LMLP financial statements, are accounted for properly and in agreement with the Agreement terms (e.g. Net Cash Flow, Additional Equity contributions, Return on Equity, Non-Arm's Length Transactions are calculated in accordance with the agreement).
- An independent validation of the pro forma financial forecasts as of 2020 and use the results of this analysis to compare against the Original and/or Updated pro forma Financial Forecasts to identify the variances between the 2010 and/or 2015 forecasts and today's current state.
- As part of the monitoring activities, that are aligned with the review processes, develop and implement enhanced controls to ensure the review process is followed consistently and develop comprehensive templates to document and track high risk areas such as additional equity, operating revenues, operating costs and Lifecyle spending year-over-year.

These processes should be documented through a standardized process, reported on in a consistent manner, reviewed by a second employee and finally approved by the City Treasurer's office and filed with the audited Financial Statements.

Audit objective 2: City accounting, equity and return on equity:

It is recommended that the City perform an annual review of the forecasts for the related municipal taxes to ensure that sufficient funding is available to service the City's debenture funding requirements in order to satisfy their obligation under the LPP agreement. Where deficits in funding are forecasted, the City should document this finding and ensure that the appropriate organizations (i.e. City Treasurer's Office) is made aware that alternate sources of funding may be required.

Audit objective 3: OSEG's accounting for their share of equity and return on equity:

It is recommended that the City complete a more detailed review of the additional equity contributions and repayments received from and made to OSEG. The impact on the Waterfall resulting from changes to the additional equity amounts can be significant. The City should feel confident that the additional equity contributions and repayments are being made in a fiscally responsible manner and in accordance with the LPP agreements.

Additionally, the City should work with OSEG to ensure that the calculations of interest are reconciled, and that the Waterfall and the Statement of Cash Flows accurately reflect the appropriate calculations for interest/Return on Equity.

The City should also request a monthly breakdown of actual Net Cash Flow results from OSEG as part of their year-end financial package and conduct a detailed variance analysis of the monthly breakdown against the reported amounts in the Statement of Cash Flows. Should any material variances be found, the City should request additional commentary and supporting documentation from OSEG to support and explain the variance(s).

Audit objective 4: City monitoring and oversight of Waterfall Distribution System:

It is recommended that the City request that OSEG provide a detailed breakdown of the interest calculation process and use this documentation to conduct an independent reconciliation on an annual basis of the interest calculations performed by OSEG in the closed Waterfall system.

It is recommended that the City validate that the agreed upon Deemed Equity amount of $23.75M is accurately reflected in the Waterfall and that the City work with OSEG to re-establish the Retail Value of the Land as of February 2020 and update the Waterfall accordingly. The City should also ensure that the Retail Value of the Land is re-established every five (5) years thereafter (i.e. February 2025, 2030, 2035 etc.) in accordance with Section 4.4(b) of the Master Limited Partnership Agreement.

Audit objective 5: City monitoring of non-arm’s length, revenue and expense transactions:

It is recommended that the City enhance their current monitoring process of non-arm’s length transactions and establish predetermined material amounts that trigger further investigation should any material differences be found during the year-end review process. This process should be documented, have identified a responsible party, an accountable reviewer and approver and the results of the review should be documented and filed in a standard template. The results and recommendations following the review should be communicated to OSEG and any areas of deemed concern should be highlighted and errors should be corrected within predetermined timelines defined by the City. Moreover, the City should conduct a second and final review of these areas of concern the following year to ensure any outstanding risks to the City have been effectively mitigated and issues addressed.

As part of this process, the City should also assess the validity of a sample of related party transactions on an annual basis. This will ensure the City is consistently up to date on these transactions at the detailed level and address any issues quickly and efficiently to ensure there are no longer-term impacts on the distributions and pro forma.

City management response

Management agreed with all of the audit's recommendations.

For detailed management responses, including planned actions and target dates, see Appendix 3 in the detailed audit report.

Detailed audit report

Introduction

The Audit of Lansdowne Accounting/Waterfall was included in the 2019 work plan of the Office of the Auditor General (OAG) approved by City Council.

To provide clarity and avoid any confusion within this report, the Lansdowne Master General Partnership (LMGP) will be referred to as LMGP/OSEG and any references to Ottawa Sports Entertainment Group will be identified by the acronym OSEG.

Purpose

The Audit of Lansdowne Accounting/Waterfall assessed whether the City's internal accounting processes for the Waterfall agreement between the City of Ottawa (City) and Ottawa Sports and Entertainment Group (OSEG) are designed and operating effectively and that all components of the City's equity contributions or return on equity are accurately recorded in the Waterfall Distribution System (Waterfall) in accordance with the Master Limited Partnership Agreement.

Background and context

In October 2012, the City entered into an agreement to form a Public Private Partnership (P3) with OSEG to transform Lansdowne Park[4].

The Lansdowne Partnership Plan (LPP) is based on a 30-year closed financial system that captures contributions (i.e. equity) and capital costs and cash flows from operations. Net cashflows from the closed system are to be distributed to the City and OSEG based on a waterfall of priorities as set out in the Master Limited Partnership Agreement, which expires on December 31, 2044. At that time, the responsibility for the stadium and parking structure will be transferred back to the City.

The Waterfall consists of six (6) levels of distribution that represent the order in which positive cash flows will be distributed. Distributions cannot be made until the previous level's distribution requirements have been fulfilled (i.e. Distributions to Level 2, OSEG Return on Equity, cannot be made until all required Level 1, Additions to the Lifecycle Fund, distributions have been completed). The Table below outlines the six (6) levels.

[4] Master Limited Partnership Agreement, October 2012

Where the City and OSEG are represented in the same level, positive cash flows are distributed equally to each partner.

Table 1: Lansdowne Master Limited Partnership Waterfall Distribution Structure

Level	Description	Definition
1	Additions to the Lifecycle Fund	Distributions made to the Lifecycle Fund to be used to maintain the assets (e.g. Retail, Stadium and Parking components).
2	OSEG Return on Equity	Distributions to OSEG for interest earned/accrued on their Equity contributions at a rate of 8% per year on a cumulative basis.
	City of Ottawa Return on Funding Equity	Distributions to the City for interest earned/accrued on the City's Funding Equity (i.e. $0) at a rate of 8% per year on a cumulative basis.
3	OSEG Return of Additional Equity	Distributions to OSEG for the return of Additional Equity.
4	OSEG Return of Equity	Distributions to OSEG for the return of their Minimum Equity (i.e. $30M).
	City of Ottawa Return of Equity	Distributions to the City for the return of its Funding Equity (i.e. $0).
5	City of Ottawa Return on Deemed Equity	Distributions to the City for interest earned/accrued on the City's Deemed Equity Contributions at a rate of 8% per year on a cumulative basis. City Deemed Equity is equal to the Retail Value (i.e. value of the retail component lands).
6	OSEG Residual Share	The balance of the available Net Cash Flow from the Total Project, excluding the Urban Park, will be distributed to OSEG and the City in equal shares.
	City of Ottawa Residual Share	

As part of the LPP, in order to limit the legal liability of the City and OSEG, the Lansdowne Master Limited Partnership (LMLP) was created in which the City and OSEG are equal limited partners and the Lansdowne Master GP Inc. (LMGP) is the general partner. LMLP owns 99.99% of each of the Component Limited Partnerships (i.e. Lansdowne Stadium Limited Partnership (LSLP), Lansdowne Retail Limited Partnership (LRLP), Ottawa 67's Limited Partnership and Ottawa RedBlacks Limited Partnership. Each subsidiary is also managed and operated by a General Partner. The

Limited Partnerships were formed under the laws of the Province of Manitoba, where the City and OSEG, as Limited Partners, are afforded greater limited liability protection. The following diagram shows the legal and ownership structure of the Lansdowne Master Limited Partnership.

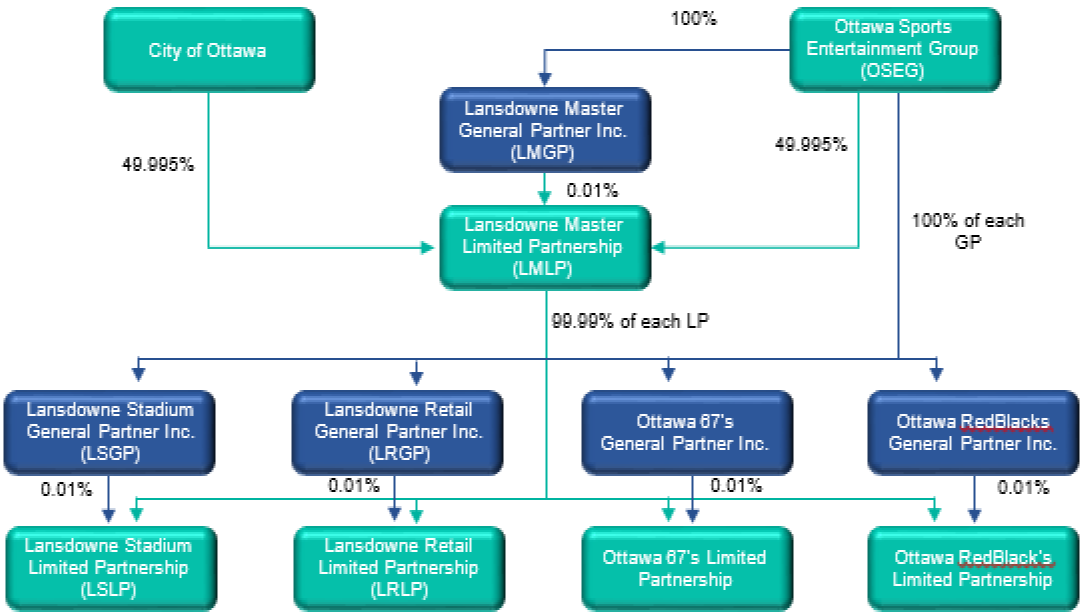

Figure 1: Lansdowne Master Limited Partnership Legal Structure

While OSEG and the City have equal interests in the LMLP, their respective returns from the partnership are provided through the Waterfall. The relative priorities set out in the waterfall system are the product of negotiations between the City and OSEG and were intended to produce a balance between contributions made to the LPP and responsibilities assumed. Both OSEG and the City have been committed to the ongoing operations of LMLP as per the agreement and as a partnership – collaborating, resolving disputes and making joint decisions to ensure both partners mutually benefit.

Audit findings and recommendations

Audit objective 1

The first audit objective was to assess the City's business planning, risk management, performance measurement and reporting.

Audit criteria 1.1

Due to the complex nature of the partnership, we would expect to find that City management are aware of the LMLP's business plans at a sufficient level of detail to allow them to challenge assumptions and advise Council and committees regarding the impact of future business plans on expected outcomes and return on equity for the City.

Findings

It was found that Corporate Finance has established a standardized review process with OSEG, who provide the financial packages to the City for their review. The packages are provided to the City within 180 days of year-end (i.e. March 31st) and include the Audited Consolidated Financial Statements and variance analysis of the prior year's budget-to-actual financial performance.

Corporate Finance conducts a variance analysis of the financial results year-over-year and flags any variances deemed unreasonable for discussion with OSEG, where the City defines "unreasonable" as over a 5-10% variance. The Deputy City Treasurer, then reviews the financial package with the Chief Financial Officer of OSEG to obtain additional information, discuss noted variances and areas of concern.

We found that the financial packages provided to the City by OSEG are of the level of detail that allows them to perform basic vertical and horizontal (e.g. year-to-year and account-to-account comparisons) financial statement analysis. However, it was found that the 2018/2019 variance analysis was not as detailed as the 2017/2018 variance analysis, as the City realigned their focus on key net differences from the previous years. This shift in focus does not provide the level of detail required to effectively identify and address material variances at a detailed level. The Deputy City Treasurer, stated that the "[City] went into significant detail in the earlier years and then each year the focus became more about the key net differences from the previous years.[5]" This high-level approach limits the City's ability to identify any underlying issues or areas of

[5] Meeting with City Finance on January 14, 2020.

concern that they may wish to seek further clarification on. Furthermore, OSEG has not provided notes or explanations behind their methodology and assumptions (i.e. inputs) used in the forecast, but they are discussed with City staff. Documenting the methodology and assumptions would help to provide an explanation and a history of what drivers and/or external factors OSEG considered in the development of and/or revisions to the financial forecasts. The absence of this documentation limits the City's ability to conduct a thorough independent analysis to determine reasonableness of the assumptions and/or changes in those assumption from year-to-year and their direct impact on the financial forecasts. The reasonability of the assumptions is based on various factors which may include the results of variance analyses of historical forecasts versus actual results (i.e. have historical variances been reflected in current assumptions?), current market conditions (i.e. are retail market forecasts for the region and/or the success/competitiveness of the sports teams considered in the forecasts?) and external factors (i.e. has the impact of the COVID pandemic has been integrated in to the forecasts?), which are all discussed with City staff but not documented fully.

Conclusion

The financial packages (variance analysis and consolidated financial statements) provided to the City by OSEG are of the level of detail required to allow the City to perform basic financial statement analysis procedures, which included specifically identifiable costs whenever possible based on what was available in that fiscal year. However, the City's focus on year-over-year net variances may not provide sufficient insight into the financial performance/operations of LMLP. Furthermore, the lack of notes or explanations to describe the methodology used by OSEG limits the City's ability to conduct a thorough independent analysis to determine reasonableness.

Recommendation 1 – Notes on basis of allocation and assumptions used in forecast

It is recommended that City increase the level of detail in their annual analyses to a level sufficient to identify and assess material variance at the account level and that they work with OSEG to include notes in the pro forma and Waterfall Schedule indicating the basis of allocation and assumptions used in the forecast. This would also ensure that Council is provided with a greater level of detail and assurance on the reported pro forma and forecasted outlook.

(Refer to Appendix 3 for management responses)

Audit criteria 1.2

In order to protect the City and its interests, it was expected that the City had established a risk management process to identify and mitigate risks associated with the LPP. Moreover, the City would have ranked the risks according to the City's defined risk assessment criteria and designed and implemented controls to mitigate these risks.

Findings

It was found that the City had developed an operational Risk Register for the Lansdowne Partnership that identifies 13 risks and corresponding controls to mitigate these risks, which are assessed based on impact and likelihood and classified as high, medium-high, medium or low risk. However, the Risk Register does not include risks related to the long-term objectives of the agreement and financial risks related to the Waterfall, nor were the risks ranked from highest to lowest risk.

In addition, while mitigation activities were identified for all high and medium level risks, it was found that some of these activities were not effective. For example, although the Risk Register states that the City will continue to monitor Transportation Demand Management (TDM) support, we found that the TDM Coordinator position is unstaffed.

Additionally, although the risk register states that the City will work closely with OSEG to update the details provided on the annual itemized workplan to provide clear records of the proposed lifecycle plans, it was found that the City is not consistently monitoring lifecycle plans for the stadium and parking structure. For example, OSEG provided the City with Capital Replacement Reports for the Capital Replacement Fund (CRF) Actual Expenses for 2017 and 2018, which include a description of maintenance activities completed (e.g. electrical room upgrades) and the cost of the maintenance activities. However, for the period between December 2017 and November 2019, there is no evidence that the City monitored progress against Lifecycle Plans for the Stadium and the Parking Structure.

As stated in the Follow-Up to the 2017 Audit of the Management of the Lansdowne Contract, as of March 2020, we found that the City has started developing tools for the ongoing monitoring of progress against the lifecycle plans for the Stadium and Parking Structure, including:

- Process documents are being developed to document the process for monitoring progress against the lifecycle plans for the Stadium and Parking Structure, including who is responsible for performing monitoring activities.

- A tracking spreadsheet has been developed for the period from 2020 to 2024 which lists work items from the Lifecycle Plans, the year in which they were recommended to be completed and the estimated cost. The spreadsheet also tracks OSEG's proposal for when work should be completed so that discrepancies can be tracked (e.g. the replacement of the artificial turf was recommended by Morrison Hershfield for completion in 2024, however, OSEG recommended this be completed in 2020 due to changes in the Canadian Football League's concussion protocol).

Both the gaps in the City's Risk Register and ineffective mitigation activities demonstrate limitations in the City's risk management practices and highlight the areas that require improvement in order to increase the effectiveness and efficiency of the City's practices.

Furthermore, risk-owners have been identified for each risk as a control within the Risk Register to ensure responsibility is assigned. However, the risk-owner is at the departmental level (e.g. RCFS, PIED, etc.), which may result in a lack of accountability for risk mitigation activities within the departments. It was also found that the *Transportation Coordinator for Special Events* risk has up to four (4) risk-owners (RCFS, Transportation Services, PIED and Legal) identified for this single risk.

Conclusion

It was found that the City has developed a Lansdowne Risk Register that identifies 13 risks that were assessed based on impact and likelihood and classified as high, medium-high, medium or low risk. However, the Risk Register does not include risks related to the long-term objectives of the agreement and/or financial risks related to the Waterfall nor were they ranked from highest to lowest risk.

It was also found that the City has assigned mitigation activities for risks identified in the Lansdowne Risk Register and risk-owners had been assigned. However, it was found that mitigation activities were not always effective, and the owners are at the departmental level, which may result in a lack of accountability for risk management and mitigation activities within departments.

Recommendation 2 – Risk assessment of long-term objectives and financial risks

It is recommended that the City conduct a thorough risk assessment of the long-term objectives related to the LMLP and its contractual obligations under the related agreements and develop mitigation strategies to ensure that the City effectively manages and monitors these risks.

Recommendation 3 – Mitigation controls and activities review

The City should conduct a review of the controls and activities designed to mitigate risks and implement these controls to ensure a pro-active approach to risk mitigation. For example, identifying specific individuals/roles responsible for managing risks and ensure that those individuals are aware of their roles and responsibilities relating to the management and mitigation of risks. This includes but is not limited to developing clear action plans and providing regular updates to illustrate risk trends over time.

Audit criteria 1.3

It was expected that the City would have established a process to monitor, analyze, and challenge financial results against the intended outcomes of the LPP. Specifically, the City would have designed and implemented a process to analyze the financial results of the LPP against the original approved financial model, where the results of this analysis are documented and approved.

Findings

Original financial model(s)

The City was not able to provide a copy of the original financial model used to support the original proposal to council or the related financial assumptions. As a result, copies of the 2009 and 2010 Financial Models were retrieved from the Office of the Auditor General's (OAG) "Audit of Lansdowne Live" audit file repository.

The Lansdowne Live Financial Models were developed by a third party and include pro forma[6] financial forecasts (i.e. projected financial statements and waterfall distribution forecasts) based on a set of documented assumptions and the schedule and expected

[6] Pro forma is defined as a financial update of the 30-year projections.

transactions for the life cycle plan for the LPP's assets[7]. We found that the 2009 model was subsequently updated in 2010 to take into account revised/additional assumptions based on new information relating to the Lansdowne Project and the associated project cost estimates. To the best of our knowledge, this is the version of the model that was used to support the proposal to Council in 2010 and the "Original" Pro forma Financial Forecasts.

Through discussions with the City Manager's Office, we found that the original approved model had been revised in 2012[8] and 2015. Between 2010 and 2012, the LPP had advanced significantly in design, planning and development and thus, OSEG refined their estimates and assumptions. The updated 2015 forecasts were presented to the Finance and Economic Development Committee (FEDCO) and City Council on December 1st, 2015[9] to inform the committee and Council that there was no longer a prospect of a return on the City's investment. OSEG initially presented the 2015 "Updated" Pro forma Financial Forecasts at a Unitholder meeting[10], held on June 5, 2015. This update and the Annual Report to FEDCO and City Council reflected the LMLP results to date as of December 31, 2014, the first full year of operations, and updated assumptions, which identified for the first time a substantial decrease in the City's forecasted returns. The tables below compare the 2012 and 2015 pro forma financial forecasts.

[7] LPP's assets is defined as the Stadium, Retail and Parking components.

[8] Lansdowne Partnership Plan Financial Update (PwC), September 24th, 2012

[9] Lansdowne Partnership Plan Annual Report to FEDCO and City Council, December 9th, 2015

[10] Unitholder is defined as an investor who owns one or more units of a master limited partnership. As per the Master Limited Partnership Agreement, the General Partner must convene annual Unitholder Meetings within 180 days of the end of each fiscal year to review budgets and strategies.

Table 2: Comparison of 2012 and 2015 Net Cash Flow Forecasts (in Nominal $[11])

Description	2012 (Millions)	2015 (Millions)	Variance (Millions)
Net Cash Flows from Sports Operations	$116.0	$139.8	$23.8
Net Cash Flows from Retail Operations	$163.0	$202.9	$39.9
Net Cash Flows from Other Non-Operating Activities	$35.3	$81.3	$46.0
Total Net Cash Flows	**$314.30**	**$424.0**	**$109.70**

Table 3: Comparison of 2012 and 2015 Total Forecasted Waterfall Distributions (in Nominal $)

Waterfall category	2012 (Millions)	2015 (Millions)	Variance (Millions)
L1 - Additions to Lifecyle Fund	$58.5	$64.2	$5.7
L2 - OSEG Return on Equity	$73.1	$259.5	$186.40
L2 - City of Ottawa Return on Funding Equity	$0	$0	$0
L3 - OSEG Return of Additional Equity	$26.3	$63.5	$37.2
L4 - OSEG Return of Minimum Equity	$30.0	$36.8	$6.8
L4 - City of Ottawa Return of Equity	$0	$0	$0
L5 - City of Ottawa Return on Deemed Equity	$60.8	$0	($60.8)
L6 - OSEG Residual Share	$32.8	$0	($32.8)
L6 - City of Ottawa Residual Share	$32.8	$0	($32.8)
Total Net Cash Flows	**$314.30**	**$424.0**	**$109.70**

[11] “Nominal $” represents the total values without taking into account the Net Present Value (i.e. discounting future dollar values to present day values).

Table 4: Comparison of 2012 and 2015 Total Forecasted Waterfall Distributions by Recipient (in Nominal $)

Waterfall category	2012 (Millions)	2015 (Millions)	Variance (Millions)
Lifecycle Fund	$58.5	$64.2	$5.7
City	$93.6	$0	($93.6)
OSEG	$162.2	$359.8	$197.60
Total Net Cash Flows	**$314.30**	**$424.0**	**$109.70**

Table 5: Waterfall Distribution Variance Overview

Waterfall category	Description
L1 - Additions to Lifecyle Fund	Increase in lifecycle contribution requirements per the revised lifecycle plan, updated to reflect more detail regarding installations, which was available in 2014 but was not available on the design drawings in 2012.
L2 - OSEG Return on Equity	An increase in OSEG's Additional Equity Contributions (See L3 below) and delays in the repayment of OSEG Additional and Minimum Equity contributions due to deficits projected over the next several years resulted in a significant increase in OSEG's Return on Equity.
L2 - City of Ottawa Return on Funding Equity	No Change
L3 - OSEG Return of Additional Equity	Additional Capital Costs of $53.6M[12] and negative cash flow forecasts result in increased OSEG Additional Equity contributions.
L4 - OSEG Return of Minimum Equity	The 2015 Annual Update to Council shows a $36.8M Return of Minimum Equity to OSEG, which should have been limited to the initial investment of $30M. The extra $6.8M was either erroneously recorded under Return of Minimum Equity instead of Additional Equity, or it should have flowed through to L5, City of Ottawa Return of Deemed Equity.
L4 - City of Ottawa Return of Equity	No Change

[12] $53.6M in additional Capital Costs consists of $20M in increased Retail Construction Costs, $10M in Technology Fit-up and $23.6M to remediate the steel corrosion on the roof of TD Place, which was later converted to a Commercial Loan and removed from OSEG Additional Equity/Return on Equity.

Waterfall category	Description
L5 - City of Ottawa Return on Deemed Equity	Insufficient cash flows to forecast waterfall distributions at the level.
L6 - OSEG Residual Share	Insufficient cash flows to forecast waterfall distributions at the level.
L6 - City of Ottawa Residual Share	Insufficient cash flows to forecast waterfall distributions at the level.

Following the presentation of the updated 2015 forecast, Council was presented with a dispute relating to the costs to remedy the steel corrosion in the roof at TD Place. LMLP incurred $23.6M in costs to rectify the steel corrosion issue, which was funded through equity contributions from OSEG. The treatment of these costs were disputed between the City and OSEG, OSEG felt that the City should have incurred these costs as the steel corrosion was not found during the due diligence review of the site, while the City cited that it exceeded the City's budget of $135.8M as per the Lansdowne Redevelopment Project Stadium and Improvements[13]. Moreover, it was found that the budget and subsequent repairs had not been approved by the City prior to OSEG incurring these costs[14].

Council agreed to resolve the dispute, as the costs related to fixing the roof were not a consequence of OSEG but related to the lack of investment and maintenance by the City, prior to LMLP, to safeguard the asset. Council ultimately approved an option that required that the City guarantee a commercial loan to enable LMLP to obtain a more favourable interest rate, estimated at approximately 3.5%. This meant that OSEG was returned $23.6M and would no longer continue to earn 8% on this contribution. It was noted that OSEG's preference was to remove the $23.6M in additional equity from the Waterfall[15].

While the City Manager's office indicated that the 2015 Updated Pro forma Financial Forecasts were considered to be the new baseline, thus eliminating the need for any

[13] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 30.

[14] Finance and Economic Development Committee Meeting Recording, December 1, 2015. Retrieved from: http://app05.ottawa.ca/sirepub/mtgviewer.aspx?meetid=6463&doctype=AGENDA

[15] Finance and Economic Development Committee Meeting Recording, December 1, 2015. Retrieved from: http://app05.ottawa.ca/sirepub/mtgviewer.aspx?meetid=6463&doctype=AGENDA

pre-existing pro forma financial forecasts and assumptions approved by Council, they did not include the required adjustments resulting from Council's approval of the revised treatment of the $23.6M costs related to the steel corrosion at TD Place nor did we find any documented evidence that this was the case. We did not have access to the details supporting 2015 Updated Financial Forecasts and therefore could not complete a detailed analysis, however, the expected implications of the settlement agreement would be a reduction in the Net Cash Flows available for distribution (i.e. the $23.6M required to repay the commercial loan, plus interest over the repayment period), a reduction in OSEG's Return on Equity (i.e. 8% interest on $23.6M removed from OSEG's Additional Equity balance) and a reduction of $23.6M in OSEG's Return of Additional Equity.

Analysis of financial results against original financial model

As mentioned in the Original Financial Model(s) section above, the Original Pro forma Financial Forecasts were revised on an annual basis to reflect the impacts of actual performance for the year and any resulting changes to the assumptions. These "Revised" Pro forma Financial Forecasts are used for year-end reviews and year-over-year analyses. Major updates to the forecasts occurred in 2012 and 2015 as a result of significant changes to assumptions or a major event. These "Updated" Pro forma Financial Forecasts were presented by OSEG in the Unitholder Meetings and subsequently documented in the Annual Reports to FEDCO and City Council.

Although the 2015 Updated Pro Forma Financial Forecasts represented a significant change in the financial outlook for the LMLP and the City's and OSEG's expectations for return on equity, these forecasts are not being used today to report against actual results. On an annual basis, the Revised Pro forma Financial Forecasts are compared to the previous year's adjusted figures to demonstrate progress against forecasts and the long-term implications of the most recent results on the waterfall distributions to both the City and OSEG. However, the year-over-year comparison does not provide the City and/or Council with a full picture of how current performance fares against original and/or updated assumptions and expected outcomes (whether it be against the 2010 Original, the 2012 Updated or the 2015 Updated Pro forma Financial Forecasts). Although we are in agreement that the pro forma financial forecasts should be revised annually in order to reflect the impact of actual performance and updated assumptions on the forecasts, the current process does not allow for an assessment of the cumulative impact of actual results against the original/updated projections and/or expected return on investment. This is important because the projections have shifted substantially since the inception of LMLP, to a point where based on the 2015 update, the City is no longer expected to receive any return and the original expected value for the City has been significantly impacted.

Financial results monitoring process

We also expected that the City would have developed and implemented a process to monitor the financial results of the LMLP in a consistent manner with well-defined outputs, accountability, and approval processes and that they perform an independent analysis of the reported financial results. While we did find that some processes had been established by the City to monitor various financial results and key agreement requirements, there were some limitations and gaps identified in these processes.

For example, the City has established a review process to monitor the spending of the lifecycle fund (i.e. maintenance fund for existing property/assets). The City reviews annual lifecycle spending and interest earned in the segregated accounts and reconciles them to financial statements on an annual basis, yet this process does not include comparing planned versus actual lifecycle repair and maintenance costs[16]. Corporate Finance stated that the LMLP agreement established thresholds at which OSEG must inform the City of deviations from the lifecycle plan. However, in 2016, OSEG spent $662,486 more than budgeted for HVAC replacements. Neither OSEG nor the City had documented evidence of an approval for this expenditure and it was found that OSEG did not provide Lifecyle Annual Reports to the City for 2015 and 2016. This illustrates some gaps in the City’s monitoring practices related to the Lifecycle, where the City’s current process does not allow for sufficient oversight to effectively track and meet agreement requirements.

It was also found that the City has implemented review processes for both annual and quarterly financial results. The quarterly financial results review process, owned by the City, is limited to reviewing the quarterly financial statements provided to the City by OSEG for significant anomalies (e.g. variances, irregularities, etc.) by comparing the results from previous years' balance sheets and income statements. Any anomalies are

[16] As per the agreements (e.g. Stadium Lease and Parking Structure Reciprocal Agreement), a Lifecycle Plan must be obtained from a qualified engineer approved by the landlord and Annual Reports must be provided to document, summarize and report on the implementation of the most current Lifecycle Plan. Moreover, a summary of withdrawals from the trust accounts must be provided on an annual basis. The Follow-up to the 2017 Audit of the Management of the Lansdowne Contract found that gaps still exist within the City’s monitoring practices of Lifecyle Plans.

flagged and noted as areas of concern/question and a more in-depth variance analysis is completed at year-end. Once this review is complete, the quarterly financial statements are filed away and retained for tracking purposes. The City has implemented some controls for this review, but could do more, such as to ensure that these reviews are approved, and summaries or briefings prepared.

The Annual Financial review process is completed at year-end by Corporate Finance. The City performs a variance analysis using the audited Consolidated Financial Statements of the LMLP. This analysis identifies year-to-year variances in key Statement of Operations accounts (e.g. Total Revenue, Total Expenses) and Statement of Financial Position accounts (e.g. Total Assets, Total Liabilities, Total Equity). The objective of this review is to assess reasonability of year-to-year changes, with reasonability being defined as no more than 5-10% variance year-over-year. Any noted unreasonable variances and concerns are then discussed during the pre-meeting with the Senior Vice President – Finance & Technology from OSEG to get a clear understanding of why the variance(s) occurred.

We found that this process includes clearly assigned accountability within Corporate Finance and roles and responsibilities for Corporate Finance, OSEG and unitholders. The outputs of this review (e.g. completed variance analysis checklist, pre-meeting discussions, Unitholder meeting minutes and the annual report) are consistent and completed on an annual basis. The approval of this review is done by the unitholders once they have been briefed on the results at the Unitholder Meeting. While some accountability has been assigned and some controls implemented, there are some gaps and limitations within this process. Specifically, the responsible and accountable individuals (e.g. Corporate Finance) are not required to provide an approval prior to OSEG presenting the financial results to senior management and the unitholders at the Unitholder Meeting.

It was also found that the City relies on the Audited Consolidated Financial Statements results to reconcile the Net Cash Flows reported by OSEG in the financial statements with the Net Cash Flows and OSEG's contributions to Additional Equity presented in the Waterfall. However, the procedures for this review, conducted by the City, is not documented. Furthermore, financial statement audits focus on the adherence of accounting practices to accounting standards and look for material errors and misstatements. As a result, financial audits may not necessarily identify issues relating to the appropriateness of accounting entries in relation to legal agreements and/or sound operational decisions, which is an important consideration in the City's review and reconciliation.

Conclusion

The City was able to refer to numerous reports that referenced the original Financial Model and assumptions. However, the City Manager's office was not able to provide a copy of the original Financial model and assumptions that were included in OSEG's approved proposal. It was found that the Original Pro forma Financial Forecasts included in the financial model proposed by OSEG and approved by Council in 2010 were updated twice, once in 2012 and a second time in 2015. These Updated Pro forma Financial Forecasts resulted in significant changes to the forecasts.

The annual update of the pro forma is completed to provide revised forecasts and their impacts on the financial outlook for LMLP, and do not compare current results against the Original and/or Updated Pro forma Financial Forecasts. As such, in our opinion, the City does not use the Original and/or Updated Pro forma Financial Forecasts during their financial results review to compare actuals performance against original and/or updated expectations. It is important to compare against original expectations as it ensures that financial performance and the partners' (i.e. The City and OSEG) anticipated returns on investment and expected value for money are being effectively monitored and tracked.

It was also found that the City has implemented a process to review the quarterly and annual financial results, which includes an internal Finance review, meetings and discussions with OSEG and presenting variances at the Unitholder Meetings. This review is primarily focused on the reasonability of year-over-year results, which is defined as no more than a 5-10% variance year-over-year. However, the City has implemented limited processes to monitor the financial statements on an ongoing basis and relies on the LMLP external financial statement auditors, to identify any material issues with reported results and reconcile cash flows in the financial statements.

As a result, we found that some monitoring processes have been designed and implemented, however, they provide limited insight into the detailed financial activities of the LMLP. Instead of completing detailed independent financial analyses of LMLP's operations, the City stated that they rely on the requirements of the agreements as the main control and trusts the financial results submitted by OSEG based on Audited Financial Statements and a review and discussion of all significant variances from budget. Nonetheless, we found that City lacks controls (e.g. review and approvals) and level of detail in their review processes, which may result in limitations to the City's oversight on the Partnership and its performance.

Recommendation 4 – Enhanced financial results review and monitoring processes

It is recommended that the City enhance and optimize their annual and quarterly financial results review and monitoring processes to include the following:

- The validation that key sections within the LMLP financial statements are accounted for properly and in agreement with Agreement terms (e.g. Net Cash Flow, Additional Equity contributions, Return on Equity, Non-Arm's Length Transactions are calculated in accordance with the agreement).
- An independent validation of the pro forma financial forecasts as of 2020 and use the results of this analysis to compare it to the Original and/or Updated pro forma Financial Forecasts to identify the variances between the 2010 and/or 2015 forecasts and today's current state.
- As part of the monitoring activities, that is married to the review processes, develop and implement enhanced controls to ensure the review process is followed consistently and develop comprehensive templates to document and track high risk areas such as additional equity, operating revenues, operating costs and Lifecyle spending year-over-year.

These processes should be documented through a standardized process, reported on in a consistent manner, and finally approved by the City Treasurer's office and filed with the audited Financial Statements.

Recommendation 5 – Return on investment assessment

It is recommended that Corporate Finance conduct an assessment of return on investment (e.g. value for money) to verify if expectations for outcomes are still in line with the original value proposition and/or the current updated expectations. We recommend that this assessment be conducted every 10 years (e.g. three (3) times during the lifecycle of LMLP).

Audit criteria 1.4

Given the complexities associated with this partnership and extensive agreement requirements, we expected that the City's performance measurement and reporting processes to senior management and Council are detailed, accurate and timely. Moreover, the City would have designed and implemented independent processes to measure financial performance and report financial performance to senior management.

As described above in Audit Criteria 1.3, it was found that Corporate Finance has designed and implemented a process to measure and report financial performance to senior management. This process includes:

- Reviewing and analyzing the budgetary and Audited Consolidated Financial Statements provided by OSEG, namely the annual variance analysis mentioned above is completed by the City to compare year-over-year financial results.
- After the variance analysis is completed, the Deputy City Treasurer meets with the OSEG Senior Vice President – Finance & Technology to review the details and then raise any areas of concern with him. The Deputy City Treasurer also raises those same concerns with the City Treasurer, who can then raise it at the meeting with the City Manager or the unitholders meeting.
- The Deputy City Treasurer then meets with the Senior Vice President – Finance & Technology from OSEG for a line item review of budget variances and changes to the pro forma financial forecasts. The focus of the discussion is on significant variances (i.e. variance of over 10% from previous years), which are typically one-time variances. Smaller variances are also discussed if they are due to changes of a more permanent nature.
- The previous year's financial results and comparison to budget, the budget for the next fiscal year and updated pro forma financial forecasts are presented to the partners.
- The LPP Financial Statements provided to the partners are detailed and allows the user to perform basic financial statement analysis. The amounts are broken down into detailed line items and significant notes and accounting policies are disclosed.
- Finally, an annual report summarizing the significant variances in the financial results, updated pro forma financial forecasts and flagged areas of concern/importance is then prepared for council review. Within the annual report, OSEG's update on the performance of the Lansdowne Partnership is provided. This section of the report briefs City senior management on key performance

indicators, summary of financial results year-over-year and waterfall distributions, update on the pro forma (e.g. position), significant matters, risk mitigation, financial implications and overall strategic review. The financial information contained provides senior management with a year-over-year view of the major discrepancies found during the variance analysis conducted by Corporate Finance.

It was also found that the financial analyses provided in the Lansdowne Partnership Plan Annual Report dated April 10, 2019 and November 27, 2019 were performed in a timely manner before the FEDCO meetings. The City Manager Report was submitted and reviewed by FEDCO and Council well before the FEDCO meeting took place. Additionally, based on FEDCO and Council comments in the Lansdowne Partnership Plan Annual Reports, it is evident that City senior management (e.g. City Manager's Office, City Treasurer, etc.) have reviewed the briefing documents and provided comments, follow-up action items, and approvals.

Conclusion

The performance measurement and reporting processes to senior management were found to be detailed, accurate and timely. The City has designed and implemented a process to measure and report financial performance to senior management and Council, which includes a high-level variance analysis, subsequent discussions with OSEG and Corporate Finance and summarizing findings and the updated pro-forma in the annual report. This provides senior management with a clear view of the City and OSEG's current position and progress in the LMLP.

The review of financial results conducted by the City is limited to a year-over-year variance analysis, which includes a request for additional information should the variance be deemed unreasonable (e.g. 5-10%). Consequently, it can be concluded that the City's financial analysis does not include a sufficient challenge function, nor a detailed review of reported financial results by OSEG. Furthermore, although the City has not consistently performed a validation exercise, the City has implemented a process going forward that includes a reconciliation of the financial statements each fiscal year (net cash flows reported in the financial statements, pro-forma financial statements over the 30-year term, estimated distributions and OSEG contribution to additional equity contributions to the waterfall to ensure accuracy). The City is using the results of the Ernst & Young (EY) specified procedures[17] engagement, and correcting errors made in the past to ensure accurate results going forward. The financial implications from the reconciliation are provided to FEDCO in the annual report and are accessible to Council.

While there are no recommendations directly related to this Audit Criteria, the recommendation to implement Enhanced Financial Results Review and Monitoring Processes (Recommendation 4) would help ensure that the City's review includes a sufficient challenge function and thus, provide appropriate and effective oversight.

Audit objective 2

The second audit objective was to assess the City's accounting processes, Equity and Return on Equity.

Audit criteria 2.1

It was expected that the City's accounting treatments for the LPP are appropriate, based on the legal structure of the partnership and Public Sector Accounting Standards (PSAS) and that the City's accounting treatments have been reviewed and approved by the City Treasurer.

Findings

Public Sector Accounting Standards or PSAS represent the accounting framework established by the Public Sector Accounting Standards Board or PSAB. The PSAB was created to serve the public interest by establishing accounting standards for the public sector.

It is the City's position that the Lansdowne Partnership does not meet the PS 3060[18] Criteria used to define a Government Partnership. Specifically, Section 3060.06b requires that the partners make a financial investment in the partnership. The City is making no cash payment into the partnership, but rather is using funds formerly used to maintain the old facility to fund debenture payments on the new works. The City is also exercising no control in the partnership, as all day to day decisions are made by OSEG which has set up a fully owned corporation to act as the General Partner of the project.

---

[17] The City engaged EY to conduct specified procedures related to the Lansdowne Master Limited Partnership Waterfall calculations from 2012-2017.

[18] PS 3060 is the section within PSAS that relates to Government Partnerships accounting practices and criteria.

Furthermore, the partners (e.g. OSEG and the City) do not share on equitable basis the significant risks and benefits, OSEG assumes the majority of all construction and operating risks and in return earns interest on contributed equity. The City receives no funds from the waterfall until all OSEG additional equity has been repaid.

As a result, the City's conclusion that the Lansdowne Partnership does not satisfy all of the PS 3060 criteria used to define a Government Partnership is supported by a complete assessment against the PS 3060 criteria, with specific references to the areas of the standard which the City feels have not been satisfied.

It was also found that the supporting documentation demonstrates that the City Treasurer's office, specifically the Deputy City Treasurer, reviewed and approved the analysis of the accounting treatment for the Lansdowne Partnership.

Conclusion

The City's conclusion that the Lansdowne Partnership does not satisfy all of the PS 3060 criteria used to define a Government Partnership is supported by a complete assessment against the PS 3060 criteria, with specific references to the areas of the standard that the City feel are not met and explanations as to why the City feels they are not satisfied. The City's assessment considers the Legal Structure of the Lansdowne Partnership, specifically their reference to the Lansdowne Master General Partner Inc., which is wholly owned by OSEG and is responsible for the day-to-day operations of the LMLP.

Audit criteria 2.2

It was expected that the City’s internal accounting processes are effectively designed and implemented to ensure that all components of the City’s equity contributions and return on equity are accurately recorded in the City’s accounting systems and calculated in accordance with the LPP agreements. This would include the City funded stadium and retail improvements and any debt associated with these improvements.

Findings

The City’s capital asset policy states that the asset recorded must include the in-use date, must be recorded at cost, that the asset is correctly classified, and the useful life aligns with policy. In order to confirm whether the asset additions have been capitalized in accordance with this policy, Amortization and Depreciation calculations were executed. It was found that the Stadium was recorded in the City's financial system in August 2014 at a value of $134,264,049. The asset is expected to have a 60-year life and no residual value. Annual depreciation for the asset is $2,237,734. Extracts from the City's financial system showed that accumulated depreciation has been properly accounted for since the asset's capitalization date in 2014. Accumulated depreciation for the period between August 2014 and December 2019 was $11,934,584. There were no improvements recognized in the City's financial system for asset improvements. Therefore, as accumulated depreciation was calculated correctly, the Stadium's net book value is accurate within the City's financial system.

According to the Project Agreement under Section 4.5 City Funding Equity, the parties agree that: “The Deemed Debenture Funding, calculated in the manner set out in the Project Agreement, is one hundred forty two million and four hundred thousand dollars ($142,400,000)”[19] and “The City Funding Equity, calculated in the manner set out in the Project Agreement, is zero dollars ($0)[20].” The City is required to service deemed debenture funding by using seventy-five percent (75%) of the municipal portion of realty taxes for the Stadium, Retail Component and Office Components and the Agreed Avoided Costs of $3.8M[21]. Upon review and validation of the City Funding Equity (CFE) from 2012 to 2019, we found that the annual financing cost of $6.97M for the Deemed Debenture Funding was calculated properly based on a 3.83% annual interest rate and a forty (40) year term.

A detailed analysis was conducted for the years 2016, 2017 and 2018 to verify whether the debenture funding requirements were effectively satisfied by using 75% or less of the municipal portion of realty taxes for the Stadium, Retail Component and Office Components and the Agreed Avoided Costs of $3.8M.

For 2016, the municipal portion of realty taxes for the stadium, retail and office components and the Agreed Avoided Costs were lower than the City's Deemed Debenture Funding requirements (i.e. deficiency of $937,117). For 2017, the municipal portion of realty taxes for the stadium, retail and office components and the Agreed Avoided Costs were higher than the City's Deemed Debenture Funding (i.e. surplus of $242,397). For 2018, the municipal portion of realty taxes for the stadium, retail and

[19] Master Limited Partnership Agreement, September 25, 2012, p 37.

[20] Master Limited Partnership Agreement, September 25, 2012, p 37.

[21] As per the Lansdowne Redevelopment Plan Project Agreement, Agreed Avoided Costs is defined as the cost for which the City and OSEG agree is the amount of annual expenses related to the Stadium that would otherwise be payable by the City had LMLP not existed (e.g. Stadium Lease and Stadium improvements). Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 120-121.

office components and the Agreed Avoided Costs were higher than the City's Deemed Debenture Funding requirements (i.e. surplus of $528,232).

Conclusion

We found that the Stadium’s accumulated depreciation has been properly accounted for in the City’s financial system since the asset’s capitalization date in 2014 and there were no asset improvements executed, nor recognized in the financial system. Therefore, the Stadium’s net book value is accurate within the City’s financial system. There were some funding pressures found in 2016 where the deemed debenture funding model did not provide sufficient funding to service the City’s Deemed Debenture Funding requirements. The deemed debenture funding model effectively satisfied funding requirements in 2017 and 2018.

Audit objective 3

The third audit objective was to assess OSEG’s accounting for their share of Equity and Return on Equity.

Audit criteria 3.1

It was expected that all components of OSEG’s share of equity and return on equity are fair, accounted for, and classified in accordance with the LPP agreements. Specifically, the OSEG calculation of additional equity requirements would be consistent with the LPP agreements and the calculation of interest and Net Cash Flow are in accordance with the methodology provided in the LPP agreements.

Findings

Calculations of additional equity

In the Lansdowne Redevelopment Plan Agreement, Minimum Equity Requirement has the meaning given to such term in Section 12.2 (a) of the Lansdowne Redevelopment Plan Project Agreement:

- *“There will be a Minimum Equity contribution to the Total Project required of OSEG in the amount of thirty million dollars ($30,000,000) subject to the provisions of Section 12.3 (the "Minimum Equity Requirement:")[22].”*

[22] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 115.

The Lansdowne Redevelopment Plan Agreement defines Additional Equity as "Equity in Excess of the Minimum Equity Requirement from time to time[23]", except as provided in Section 12.2 (c) of the Lansdowne Redevelopment Plan Project Agreement:

- *Any amount contributed by members on account of Completion Funds respecting Excess Stadium/Parking Costs, other than Stadium completion funds, shall be deemed to be additional equity, but shall not be included in the determination of compliance with the Minimum Equity Requirements. Any amount contributed by Members on account of Stadium Completion Funds shall be deemed to be Equity but shall not be included in the determination of compliance with the Minimum Equity Requirement nor deemed additional equity[24].*

The application of these definitions ensures that OSEG's Minimum ($30M) and Additional Equity Contributions are in line with the LPP agreements and appropriately accounted for in the Financial Statements and the Waterfall.

In order to verify whether OSEG's determinations of Minimum and Additional Equity were completed as per the LPP agreements, an independent analysis of the Minimum and Additional Equity transactions was conducted.

It was found that in 2014, $17.0M was added to OSEG's Minimum Equity Account despite the Minimum Equity requirement of $30.0M already being fulfilled. Subsequently, in 2015, we found that $17.0M was transferred from OSEG's Minimum Equity Account to their Additional Equity Account (See Table 6 below).

In 2015, City Council agreed to approve a settlement between the City and OSEG in relation to the steel corrosion in the roof of TD Place, OSEG was permitted to remove $23.5M[25] from the Additional Equity Account and convert it to a Commercial Loan, guaranteed by the City at a reduced interest rate[26].

---

[23] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 2.

[24] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 116-117.

[25] Original agreement identifies $23.6M, the amount of $23.5M was used in the Waterfall Distribution

[26] FEDCO Meeting (Audio), December 1st, 2015

The following Table highlights the variance found in the OSEG's accounting of the 2015 Additional Equity contributions:

Table 6: 2015 OSEG Additional Equity Contribution

Description	Financial statements[27] (Millions)	Waterfall[28] (Millions)	Variance (Millions)
Additional Equity Contributions			
Cash Contributions	$18.34	$17.14	$1.20
Property & Equipment Contributions	$4.76	$4.76	$0.00
Transfer from Minimum Equity Account	$17.00	$17.00	$0.00
Total Contributions	**$40.10**	**$38.90**	**$1.20**
Less: Return of OSEG Capital/Additional Equity	($24.70)	($17.00)	($7.70)
Expected Net Contributions to Additional Equity	**$15.40**	**$21.89**	**($6.50)**

Based on the numbers presented in the Audited 2015 Consolidated LMLP Financial Statements and the settlement agreement reached in 2015, our analysis found that the Additional Equity amount for 2015 should have been $15.4M. This calculation included 2015 Partner's[29] (Cash) Contributions of $18.34M, Partner's (Property & Equipment) Contributions of $4.76M, $17.0M transferred from the Minimum Equity Account and the Return of Partners' Capital of $24.7M.

Based on this analysis, two (2) discrepancies were identified:

- There is a $1.2M variance between the amounts reported for Partner's (Cash) Contributions ($18.34M in the audited financial statements and $17.14M in the Waterfall) and a related $1.2M variance between the Return on Partners' Capital Amounts ($24.7M in the audited financial statements and $23.5M in the Waterfall, $17.0M from Additional Equity and $6.5M from Return on Equity). The $1.2M amounts offsets one another and thus have no material impact on the Waterfall

[27] LMLP 2015 Consolidated Financial Statements, Consolidated Statement of Cash Flows & Note 17

[28] LMLP Waterfall – Current 2019.xlsx

[29] Partner refers to OSEG as a Limited Partner in LMLP.

but are incorrectly reported in the Waterfall. As the contributions recorded in the Waterfall have a direct impact in the interest earned (i.e. Return on Equity) and subsequent distributions, it is pivotal that amounts are accurately recorded and in line with actual financial performance and reporting. Although the error was found to have no material impact on the waterfall distributions, this demonstrates some gaps in the amounts reported in the waterfall and the oversight processes.

- OSEG's Additional Equity contributions for 2015 are overstated, in the Waterfall Distribution Model, by $6.5M (e.g. $21.9M in the Waterfall vs. $15.4M based on numbers found in the audited financial statements). This is the same amount that OSEG recorded as being distributed from their Return on Equity Account instead of their Additional Equity Account. These amounts offset one another and thus have no impact on the determination of OSEG's overall equity position at the time of the transaction. However, they have a material impact on the calculation of Return on Equity (i.e. interest) moving forward as interest is calculated and accrued annually on the Additional Equity balance, but not the Return on Equity balance. Therefore, ultimately this treatment is more favourable for OSEG (See Calculations of Interest Section below).

In 2015[30], City Council approved the reallocation of $23.5M from OSEG's Additional Equity Account to a long-term Commercial Loan that was to be guaranteed by the City. It was found that a $23.5M reallocation was executed, however, only $17.0M was reallocated from OSEG's Additional Equity Account. The remaining $6.5 million was reallocated from their Return on Equity Account. This resulted in the interest-bearing Additional Equity Account being overstated by $6.5M and OSEG's non-interest-bearing Return on Equity Account being understated by $6.5M. This is of importance as OSEG's treatment of this transaction has a material impact on the Waterfall Distribution Model's calculation of Return on Additional Equity (See Calculations of Interest Section below).

[30] Lansdowne Partnership Plan Annual Report to FEDCO and City Council, December 9th, 2015

Calculations of interest

In regard to the calculation of interest, the Lansdowne Master Limited Partnership Agreement Section 4.3 states the following:

- *From and after the closing date, OSEG will be entitled to a return on the outstanding amount of Equity from time to time[31] at the rate of eight percent (8%) per annum[32].*

It was found that the half-year Capital Cost Allowance[33] method used by OSEG to calculate interest was accepted by both parties at the beginning of the agreement and does not result in any material differences to OSEG's knowledge[34].

A detailed analysis was conducted on interest calculations on the Additional Equity amounts to verify whether these calculations were done in accordance with the agreement. Our analysis concluded that the interest calculations performed in the Waterfall on OSEG's Additional Equity balances were accurate and effectively applied the half-year Capital Cost Allowance method.

A detailed analysis was also conducted on the interest calculations relating to OSEG's Minimum Equity Contributions. Our analysis initially found that there was a discrepancy in the treatment of OSEG's Minimum Equity contributions between the Waterfall, where in 2012 OSEG recognized a contribution of $30.0M to Minimum Equity, and the Audited Consolidated Financial Statements, where the contribution made by OSEG for 2012 was reported as $14.27M, with a subsequent contribution in 2013 that fulfilled the Minimum Equity requirement of $30.0M.

---

[31] On one (1) or more occasions.

[32] Master Limited Partnership Agreement, September 25, 2012, p 34-36.

[33] The Half-Year Capital Cost Allowance Method is used to simplify the recognition of Capital Cost acquisitions. For any acquisition or dispositions completed during the fiscal year, whether on the first or last day of the year, or at any time in between, the acquisition is deemed to have occurred at the mid-way point during the year and therefore, only 50% of the applicable Capital Cost Depreciation Allowance applies in the first and last years. In this instance, the method is applied to any Equity Contributions received or paid out during a fiscal year. Return on Equity is calculated based on the method (i.e. 8% per annum on the equity contribution for 50% of the year or the equivalent to 4%).

[34] Meeting with David Porter, Senior Vice President – Finance & Technology from OSEG on March 3, 2020.

According to Section 4.2 (c) of the Lansdowne Master Limited Partnership Agreement, which outlines that OSEG's Minimum Equity includes "all cash contributed by a Member to OSEG to the extent required to fund the Initial Capital Contributed" and Initial Capital Contributed is defined as cash advances at or prior to Closing by each of the Members to OSEG, we were able to reconcile the differences in the reporting of Minimum Equity between the Waterfall and the Audited Financial Statements.

However, the agreement is not clear on whether OSEG is entitled to earn interest on the "Contributed Capital" amounts that had not yet been distributed to LMLP. We consulted with the City's Legal Council, but they were unable to provide a definitive interpretation of the clauses. Based on the lack of clarity and given the material impact on interest calculations, we considered both situations in our analysis.

Assuming that OSEG was entitled to earn interest on all Contributed Equity, our analysis concluded that the interest calculations performed in the Waterfall on OSEG's Minimum Equity balances were accurate and effectively applied the half-year Capital Cost Allowance method.

Assuming that OSEG was not entitled to earn interest on Contributed Equity that had not been transferred to LMLP, we found some discrepancies in the amounts reported in the Waterfall as accrued interest on Minimum Equity. Based on the timing of these contributions and the methodology used by OSEG to calculate interest, it was found that interest on minimum equity for the years 2012 and 2013 were overstated by a total of $944,022 (i.e. $314,674 in 2012 and $629,348 in 2013). These discrepancies in calculations and reported numbers could represent an area of concern for the City, as these calculations could result in subsequent distributions being misallocated. Misallocations could have a trickle-down effect and could impact future distributions and interest calculations within the Waterfall.

As noted above, OSEG's interest-bearing Additional Equity Account is overstated by $6.5M and OSEG's non-interest-bearing Return on Equity Account being understated by $6.5M. Since OSEG earns 8% interest per annum on the amount of outstanding Additional Equity and interest is non-compounding (i.e. no interest is calculated on Return on Equity amounts), by removing the $6.5M from the Return on Equity account and not the Additional Equity account, OSEG will continue to earn interest on the $6.5M of "Additional Equity" in the amount of $520,000 per year or potentially more than $14M over the remainder of the life the partnership.

Calculations of net cash flow

As per the Master Limited Partnership Agreement, Net Cash Flow is defined as "for any period, Gross Receipts for such period minus Outflows for such period. For the purpose of this Agreement, Net Cash Flow may be a positive or a negative number."[35] Gross Receipts are defined as "the aggregated gross cash receipts of the Limited Partnership (or the General Partner on behalf of the Limited Partnership) calculated on a cash basis[36]" and includes:

- *Income and capital distributions, repayment of loans, return of capital contributions and all other funds received from all Component Limited Partnerships;*
- *Contributions;*
- *Revenue received from Permitted Interim Investments*
- *Proceeds of business interruption insurance or loss of income insurance or other types of insurance*
- *Net proceeds of any disposition of any asset of the Limited Partnership of any nature or kind; and*
- *Net proceeds received from expropriation of any portion of any assets of the Limited Partnership[37].*

Outflows includes the following, "for any period amounts (without duplication)[38]":

- *Paid to any of the Component Limited Partnerships on account of Amounts Required for the Purposes of the Component Limited Partnerships;*
- *Paid under the Promissory Note; and*
- *Paid for General Expenses[39].*

[35] Master Limited Partnership Agreement, September 25, 2012, p 17.

[36] Master Limited Partnership Agreement, September 25, 2012, p 14-15.

[37] Master Limited Partnership Agreement, September 25, 2012, p 14-15.

[38] Master Limited Partnership Agreement, September 25, 2012, p 18.

[39] Master Limited Partnership Agreement, September 25, 2012, p 18.

As per Section 4.8 of the Master Limited Partnership Agreement, OSEG is required to contribute to the Limited Partnership:

- *To fund any negative Net Cash Flow to ensure that all reserve requirements are met; and*
- *To fund any other amounts required to be funded by OSEG and/or the Members in accordance with the provisions of the Project Agreement[40].*

Corporate Finance has interpreted these requirements as that any positive cash flows in any one (1) year results in distributions through the Waterfall, based on a waterfall of distribution priorities (See Table 1). However, when there are net “negative” cash flows, OSEG must contribute additional equity to make up the shortfall. This has occurred every year since the beginning of the agreement and OSEG has had to contribute additional equity each year.

Upon request of monthly cash flow calculations, OSEG confirmed that these do not exist as cash flow actuals are only reported on a quarterly and annual basis. OSEG also confirmed that going forward, budgeted monthly Net Cash Flows will be presented at the annual Unitholder meetings. In order to verify that the Net Cash Flow calculations performed by OSEG were completed as per the Agreements, we conducted a reconciliation of the Audited Consolidated Financial Statements (e.g. Statement of Cash Flows) using the method outlined in the agreements (Gross Receipts less Outflows). It was found that the reported Net Cash Flow amounts in the Financial Statements align with the calculations using the agreement calculation method.

As the Waterfall is the net cash flow distribution system, a reconciliation of the Audited Financial Statements (e.g. Statement of Cash Flows) and the Waterfall was conducted to verify whether the Cash Flow amounts aligned in both for the fiscal years 2016, 2017 and 2018-2019.

Minor variances (e.g. $1,000 - $2,000) were found for six (6) cash flow activities between 2016-2019. In 2019, it was found that there was a $10,000 discrepancy between the increase in cash reported between the Audited Consolidated Financial Statements and the Waterfall. These variances demonstrate the need to enhance the current review process to ensure that the reported cash flows are accurately captured and reported.

[40] Master Limited Partnership Agreement, September 25, 2012, p 37-38.

Conclusion

Our analyses, conducted on OSEG's reporting of their share of equity and the calculations of returns on equity, identified some discrepancies and potential areas of concern. Specifically, OSEG's treatment of the settlement agreement relating to the steel corrosion in the roof of TD Place and the application of the half-year Capital Cost Allowance produced variances in return on equity amount in excess of $15M over the life of the Partnership Agreement.

Upon reconciling the Net Cash Flow calculations, it can be concluded that the method used to calculate Net Cash Flows by OSEG is in accordance with the agreements. However, as OSEG was unable to provide a detailed breakdown of cash flows, it was not possible to assess whether the amounts were classified correctly. Additionally, some variances were found upon conducting a reconciliation exercise between the Audited Consolidated Financial Statements and the Waterfall system.

Recommendation 6 – Detailed review of additional equity contributions

It is recommended that the City complete a detailed review of the additional equity contributions and repayments received from and made to OSEG. The impact on the Waterfall resulting from changes to the additional equity amounts can be significant. The City should feel confident that the additional equity contributions and repayments are being made in a fiscally responsible manner and in accordance with the LPP agreements.

Recommendation 7 – Calculations of interest reconciliation

The City should work with OSEG to ensure that the calculations of interest are reconciled, and that the Waterfall and the Statement of Cash Flows accurately reflect the appropriate calculations for interest/return on equity.

Recommendation 8 – Monthly net cash flow calculations

It is recommended that the City requests a monthly breakdown of Net Cash Flow actuals from OSEG as part of their year-end financial package. The City should conduct a detailed variance analysis of the monthly breakdown against the reported amounts in the Statement of Cash flow. Should any material variances be found, the City should request additional commentary and supporting documentation from OSEG to support and explain the variance(s).

Audit objective 4

The fourth audit objective was to assess the City's monitoring and oversight of the Waterfall Distribution System.

Audit criteria 4.1

Due to the structure of the Waterfall, Additional Equity contributions made by OSEG have a direct and substantial impact on the distributions allocated to the Partners (e.g. Partners' expected Returns on Equity). Therefore, it was expected that the City has a process in place to actively monitor and validate the amounts contributed as OSEG additional equity to ensure they are valid and in accordance with the LPP agreements. It was also expected that the City would have a process in place to actively monitor and validate the calculation of accrued interest, distributions of equity and return on equity to partners to ensure they are valid and in accordance with the LPP agreements.

Findings

Additional equity monitoring process

As per Section 4.8 in the Master Partnership Agreements, OSEG is required to provide contributions to the Limited Partnership to cover any negative Net Cash Flow (e.g. outstanding operational expenses) and to ensure that all reserve requirements are met[41]. This reserve requirement is to contribute roughly $1.4M annually to the lifecycle reserve[42].

[41] Master Limited Partnership Agreement, September 25, 2012, p 37-38.

[42] Finance and Economic Development Committee Meeting Recording, December 1, 2015. Retrieved from: http://app05.ottawa.ca/sirepub/mtgviewer.aspx?meetid=6463&doctype=AGENDA

In regard to the calculation of Return on Equity (i.e. Interest), the Lansdowne Master Limited Partnership Agreement, Section 4.3 states the following:

- *From and after the closing date, OSEG will be entitled to a return on the outstanding amount of Equity from time to time at the rate of eight percent (8%) per annum*[43]*.*

As of the end of Fiscal Year 2018/2019, OSEG reported in the Waterfall a balance of $96.76M in Additional Equity contributions and a total accrued Return on Equity of $17.73M relating to those contributions.[44] Over the life of the partnership, the same Waterfall Distribution Model forecasts a total requirement of $105.26M in Additional Equity contributions and a total accrued Return on Equity of $238.83M relating to those contributions.

It was found that the City is not directly involved in the approval process relating to the contribution of Additional Equity by OSEG. However, the City reviews and approves annual forecasts, which may include a forecasted negative Net Cash Flows, that would most likely result in a contribution of Additional Equity from OSEG. Additionally, and as previously noted, the City relies on the Audited Consolidated Financial Statements (audited by KPMG) to reconcile Net Cash Flows reported in the Financial Statements to the Waterfall Net Cash Flows and OSEG's contributions to Additional Equity on an annual basis; however, this process only provides the City with a high-level and historical view of OSEG’s contributions of additional equity.

In 2018, the City engaged the services of Ernst & Young (EY) to perform specified procedures in connection with the LMLP Waterfall calculations for the fiscal years 2012 to 2017. This engagement concluded in April 2020 and was not a formal audit and/or review but did provide the City with some assurances that amounts included in the Waterfall reconciled with the Audited Financial Statements and that the calculations performed in the Waterfall are mathematically accurate. This was the first such engagement initiated by the City; however, the City explained their plan going forwards is to have these specified procedures repeated at regular intervals throughout the remainder of the partnership.

Collectively, these approaches can provide the City with a reasonable degree of confidence that the Additional Equity contributions made by OSEG are supported by

[43] Master Limited Partnership Agreement, September 25, 2012, p 34-36.

[44] Note that these numbers may be adjusted based on findings made under Audit Objective 3

reviewed and approved business and operational forecasts and the Waterfall is effectively tracking Partners' Equity and accurately calculating Partners' Return on Equity. However, without a detailed analysis such as the EY specified procedures, the City's processes on their own do not provide enough information for the City to have a detailed understanding of the reasoning behind the need for the additional equity. Furthermore, they do not provide any assurances that the actual amounts contributed and how they are accounted for in the Waterfall System (i.e. Equity vs. Return on Equity) are aligned with operational needs and/or the LPP agreements.

Calculation of accrued interest and distributions of interest monitoring process

The LPP Master Agreements outline how interest must be calculated for both OSEG and the City. In Section 13.4 Waterfall of the Lansdowne Redevelopment Plan Project Agreement, it is stated that:

- *To each of OSEG and the City, a return from and after the Closing Date on the outstanding amount from time to time of the Equity and the City Funding Equity, respectively, at the rate of eight percent (8%) per annum, on a cumulative but not compounded basis.*[45]

It was found that on an annual basis, the City reviews the updated Waterfall Distribution Model, which includes the calculation of Return on Equity (i.e. Interest payable to OSEG). The City explained that interest is accrued on Additional Equity and built into the Waterfall. OSEG completes the interest calculations using the half-year method[46] and includes the results of the calculations within the Waterfall document. However, there was no documentation provided to support the breakdown of how these calculations are completed (e.g. methodology and formulas used). OSEG stated that the method was accepted by both parties at the beginning of the agreement, yet evidence supporting the statement that the City approved this method was not provided.

---

[45] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 125.

[46] The Half-Year Capital Cost Allowance Method is used to simplify the recognition of Capital Cost acquisitions. For any acquisition or dispositions completed during the fiscal year, whether on the first or last day of the year, or at any time in between, the acquisition is deemed to have occurred at the mid-way point during the year and therefore, only 50% of the applicable Capital Cost Depreciation Allowance applies in the first and last years. In this instance, the method is applied to any Equity Contributions received or paid out during a fiscal year. Return on Equity is calculated based on the method (i.e. 8% per annum on the equity contribution for 50% of the year or the equivalent to 4%).

As the City has reviewed and approved financial statements and the Waterfall system; it can therefore be concluded that the City was made aware of the method being used.

The EY Specified Procedures engagement, noted above, identified some issues relating to the calculation of Return on Equity in the Waterfall and that these errors will be addressed. Going forward, the City has stated that they will include the verification of Return on Equity calculations in their annual reconciliation / validation review. As the Net Cash Flows have yet to be positive in any fiscal year to date, there have been no distributions to the partners. When a positive cashflow has been established and verified, the calculation of interest will be re-verified by both OSEG and the City before it is approved, and distributions are executed as per the Waterfall distribution system. This demonstrates that the City's process has considered the risks associated to interest calculations and subsequent distributions and implemented a control to mitigate these risks and ensure the distributions are correctly executed.

Distributions of equity monitoring process

The City's established three (3) layer "discussion system" as part of the Annual Financial Results review was found to be successful in communicating and documenting any subsequent changes to the distributions.

In regard to the Waterfall Distribution Model, the EY specified procedures engagement was the first validation exercise conducted during the lifecycle of the LMLP. The purpose of this engagement was to correct any past errors in the Waterfall and reconcile the additional equity amounts, review distributions, test OSEG's equity continuity schedule and interest calculations on minimum and additional equity. During this engagement, EY noted differences between the contributions from the partner amounts in the financial statements and the Waterfall system in the 2016 and 2017 fiscal years. EY inquired on this discrepancy with OSEG, and they explained that these repayments should have been contributed to the Ottawa Fury[47], rather than passing through incorrectly in the LMLP financial statements. This mistake has been corrected and reported to Council, as per Corporate Finance confirmation in the January 14, 2020 meeting.

[47] Ottawa Fury, or the Ottawa Fury Football Club, was a Canadian professional soccer club owned by OSEG. They played their home games at TD Place Stadium. The Fury suspended operations in November 2019.

Corporate Finance stated that the process going forwards is to continue to reconcile the Waterfall to the Audited Consolidated Financial Statements, using the EY specified procedures as the baseline. The scope of EY's work did not include the 2018/2019 financial statements and therefore, the City's responsibility to conduct the reconciliation will begin with the 2018/2019 year. The City stated that the revised annual review process going forwards would be owned by the City (e.g. Corporate Finance), however an external party will be engaged again to complete the detailed transactional analysis and reconciliation.

While the City has outlined their process going forwards, the fact that only one (1) validation exercise of the Waterfall has been completed to date and that LMLP has been in a negative Net Cash Flow position every year since operations began demonstrates an area for improvement in the City's monitoring practices.

Conclusion

While it was found that the City has established some processes to actively monitor and validate calculations of interest, OSEG's additions to equity and distributions of equity, the processes were found to have gaps and thus, warrants immediate remediation to ensure the City's interests are appropriately protected. Namely, as LMLP has been in a negative Net Cash Flow position every year since operations began, OSEG has contributed additional equity and is accruing 8% interest on their contributions. While the agreement does align with this practice, the City is not reviewing or approving the additions to equity, which based on the current Waterfall Distribution Model represents $105.26M in Additional Equity contributions and a total accrued Return on Equity of $238.83M relating to those contributions. As both OSEG's Additional Equity and the related accrued Return on Equity are paid out before the City would receive any returns, it is important for the City to be in agreement with these amounts in order for them to effectively explain the City's forecasted return from the LPP, current forecasted to be $0. Although the City has completed a validation of the Waterfall, it was only recently completed, over seven (7) years after operations began. The City explained that this validation exercise was initiated as soon as realistically possible to allow for sufficient operational activities, where the EY specified procedures engagement began in 2018.

The City's limited annual review process (i.e. variance analysis and irregularities) further compounds the impact of completing only one (1) validation of this system to date, as the annual review is not granular enough to identify and flag issues related to additions of equity, interest calculations and distributions.

It was also found that the City and OSEG have established a process with controls to review calculation of interests once a positive cash flow has been established and verified, where the interest calculations will be re-verified by both OSEG and the City prior to approving and executing distributions. As a positive Net Cash Flow situation has yet to occur, this process has yet to be initiated. However, verifying that the equity accounts and associated returns on equity are calculated properly on an ongoing basis would ensure that an accurate reflection of the City's return on investment is being presented to Senior Management and Council on an annual basis.

Recommendation 9 – Documented calculation of interest process and independent reconciliation exercise

It is recommended that the City request that OSEG provide a detailed breakdown of the interest calculation process and use this documentation to conduct an independent reconciliation on an annual basis of the interest calculations performed by OSEG in the closed Waterfall system. This independent reconciliation process should be documented, have identified a responsible party, accountable reviewer and approver and results of the review should be documented and filed in a standard template.

Audit criteria 4.2

It was expected that all components of the City's equity contributions and return on equity have been accurately recorded in the Waterfall in accordance with the LPP agreements.

Findings

As stated above, Section 4.5 of the Project Agreement states that City Funding Equity is defined as: "The parties agree that the City Funding Equity, calculated in the manner set out in the Project Agreement, is zero dollars ($0).[48]" A reconciliation was conducted and found that the City Funding Equity has been determined accurately as per the method outlined in the agreements.

As per Section 12.5 of the Project Agreement, Determination of City Funding Equity, "City Funding Equity means and shall be calculated as of the Calculation Date as follows":

[48] Master Limited Partnership Agreement, September 25, 2012, p 37.

- *The Lesser of: a) the Maximum City costs; or b) the actual costs borne by the City for the Stadium Improvements and the City's Share of Cost of Parking (calculated using the same inclusions and exclusions of costs as are used in this Agreement for the Maximum City Cost, mutais mutandis, including the inclusions and exclusions described in Sections 5.2(b) and (c);*
- *minus the amount of the Deemed Debenture Financing; minus seven million seven hundred sixteen thousand eight hundred and seventy-nine dollars ($7,716,879) payable by the Residential Developer for the Residential Air Parcels.*[49]

Maximum City Costs is defined as “one hundred thirty-five million eight hundred thousand dollars ($135,800,000) (exclusive of any applicable GST/HST) or such higher amount as may be approved by Council.[50]” While Residential Air Parcel is defined as “The City has determined in its Discretion that each Residential Project shall be created on a freehold air parcel in order to permit the creation of residential condominiums for sale to individual purchasers[51]”. It was found that the Calculation Date is noted as July 31, 2012. Furthermore, an amount of seven million seven hundred sixteen thousand eight hundred and seventy-nine dollars ($7,716,879) payable by the Residential Developer (i.e. Trinity[52]) for the Residential Air Parcels is identified in section 12.5 (b)(iii) of the Agreement[53].

Using these various definitions, a verification was completed to confirm whether the City funding Equity amounts in the Waterfall are correct. It was found that City Funding Equity in the Waterfall is zero ($0), which aligns with the agreements and expectations as such.

[49] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 121-22.

[50] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 30.

[51] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 97.

[52] Trinity is one of the non-arm’s length related parties. The full list of related parties is included in Appendix 2.

[53] Master Limited Partnership Agreement, September 25, 2012, p 63.

As per Section 4.4(b)[54] of the Master Limited Partnership Agreement, the City will receive credit for deemed equity equal to the Retail Value[55] of the land, which at the time of closing was set at $23.75M. Section 4.4(b) also stipulates that the Retail Value of the land should be re-established (e.g. assessed and reset based on the reviewed value) on the fifth (5th) anniversary of the Operating Term Commencement Date and every five (5) years thereafter.

It was found that the Deemed Equity amount was recorded as $24.0M and not $23.75M in the Waterfall. Moreover, we also found that the Retail Value of the Deemed Equity was not re-established on the fifth (5th) anniversary of the Operating Term Commencement Date[56] (i.e. February 17, 2015) as per the requirement in the agreements.

The EY specified procedures identified the discrepancy between the recorded amounts and noted that an adjustment had been made by OSEG in the current Waterfall to correct this error.

While corrections have been made to rectify the errors mentioned above, these findings illustrate gaps in the City's oversight and monitoring practices. The lack of re-establishment of the Retail Value is especially of concern, as the City's return on Deemed Equity is based on the value of this re-establishment.

Conclusion

As per Section 4.5 of the Master Limited Partnership Agreement, the City Funding Equity was determined in the manner set out in the Project Agreement is zero dollars ($0). It was found that within the Waterfall, City Funding Equity is $0. As such, it is concluded that City funding equity has been accurately calculated and included in the Waterfall.

As per Section 4.4 of the Master Limited Partnership Agreement, the City Deemed Equity amount was determined to be $23.75M. It was found that the Deemed Equity was erroneously recorded in the Waterfall and that the Waterfall does not include a re-establishment of the Retail Value/Deemed Equity amount in 2020, as per requirement outlined in Section 4.4(b) of the Master Limited Partnership Agreement.

---

[54] Master Limited Partnership Agreement, September 25, 2012, p 36.

[55] The value of the Retail Component.

[56] Finance and Economic Development Committee Report 10, December 9, 2015 (Page 42)

Recommendation 10 – Verification of the City's deemed equity contributions

It is recommended that the City validate that the agreed upon Deemed Equity amount of $23.75M is accurately reflected in the Waterfall and that the City work with OSEG to re-establish the Retail Value of the Land as of February 2020 and update the Waterfall accordingly. The City should also ensure that the Retail Value of the Land is re-established every five (5) years thereafter (i.e. February 2025, 2030, 2035 etc. in accordance with Section 4.4(b) of the Master Limited Partnership Agreement.

Audit objective 5

The fifth and final audit objective was to assess the City's monitoring of Non-arm's length[57] revenue and expense transactions

Audit criteria 5.1

It was expected that the City has identified and is actively monitoring non-arm's length transactions to ensure the transactions have been treated in accordance with the LPP agreements. Specifically, the City would have identified Non-arm's length transactions and established a process to monitor and validate these transactions.

Findings

As per the Lansdowne Redevelopment Plan Project Agreement, Section 5.14:

- *Any agreement or arrangement entered into by OSEG or any of the Component Partnerships with any non-Arm's Length Person shall contain terms and conditions consistent with an agreement entered into with Persons dealing at Arm's Length and shall require the City's prior approval with respect to such conformity with Market Terms and Conditions.*[58]

[57] Non-arm's Length Transactions are transactions between two (2) or more entities where the entities have a mutual interest and/or may mutually benefit from a business transaction. As such, the business entities may not/cannot act independently.

[58] Lansdowne Redevelopment Plan Project Agreement, September 25, 2012, p 90.

As per Section 5.2 of the Master Limited Partnership, Non-arm's length transactions are defined as:

- *Without derogating from provisions contained in the Project Agreement, or the Component Limited Partnership Agreements with respect thereto, in the event that there shall be a non-arm's length transaction, which shall have been approved by the City (as required in accordance with the Project Agreement), notwithstanding the terms and conditions contained in any contract or agreement thereto, all revenues, expenditures and other terms thereof (as Approved by the City) shall be deemed to be on terms and conditions that would be applicable to an Arm's Length Transaction in similar circumstances.*
- *Non-Arm's Length Transaction means any transaction entered into with any person not at arm's length with OSEG, any member of OSEG or any Permitted Transferee[59].*

"Arm's Length" has the meaning given to such a term in the Income Tax Act (Canada)[60]:

- *Related persons shall be deemed not to deal with each other at arm's length;*
- *A taxpayer and a personal trust (other than a trust described in any of paragraphs (a) to (e.1) of the definition trust in subsection 108(1)) are deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, would be beneficially interested in the trust if subsection 248(25) were read without reference to subclauses 248(25)(b)(iii)(A)(II) to (IV); and*
- *In any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.[61]*

[59] Master Limited Partnership Agreement, September 25, 2012, p 39.

[60] Master Limited Partnership Agreement, September 25, 2012, p 2.

[61] Income Tax Act, RSC 1985, c. 1 (5th Supp.). Retrieved from https://laws-lois.justice.gc.ca/eng/acts/I-3.3/section-251.html

Non-arm's length transactions monitoring process

We found that the City performs a general annual review of the related party transactions, where the City notes any significant changes year-over-year. This review includes verifying if there are any material increases or decreases in the Related Party Transactions (i.e. with non-arm's length entities) within the Statement of Cash Flows from the Audited Consolidated Financial Statements and assessing the reasonability of the change. The Audited Consolidated Financial Statements also contain a "Note" specific to the Related Party Transactions and include balances from the current and previous fiscal years.

Corporate Finance are aware of every line item in the Financial Statements; however, the transaction level details are not included in these statements. As per the agreements, the City has the right to request invoices, receipts and any supporting documentation to review at the transactional level. Any review at the transaction level is done on an as-requested basis. Therefore, for any noted areas of concern for related party transactions identified during the annual variance analysis, the City can request supporting documentation and additional details at the transaction level. While it was found that the City has implemented a process to monitor non-arm's length transactions, it does not include consistent and recurring review at the transactional level. Due to the risks associated to non-arm's length transactions, a general review may not be sufficient to effectively monitor these transactions.

Assessment of the validity of non-arm's length transactions

As part of EY's specified procedures engagement in 2019, EY sampled Non-Arm's Length transactions and tested "the eligibility of the costs incurred by OSEG against the definitions included within the applicable agreement(s)"[62]. This review is the only detailed review exercise of the non-arm's length transactions since operations began, however, the scope of the review included all years dating back from 2012 to 2017. During this review, 18 related parties[63] were identified by OSEG and the City and testing was performed on sampled transactions. There were no findings noted following their assessment.

[62] Report on Applying Specified Procedures to the Lansdowne Master Limited Partnership 2012-2017 Waterfall Calculation (April 2020)

[63] List of all related parties is included in Appendix 2.

Going forward, during the Year-End Financial Results Review Process, Corporate Finance will include a step to identify and assess any non-arm's length transactions flagged as an area of concern (e.g. unreasonable variance of 5-10% year-over year). If a variance is noted year-over-year and deemed unreasonable, the City would flag this area and request additional details at the transactional level. Any transactions that are flagged as areas of concern will be reviewed at the transactional level. This review could either be done by internal City staff or by a hired external auditor again.

In order to verify the validity of non-arm’s length transactions, the LMLP related parties, including the Component Limited Partnerships, were assessed. These include the Ottawa 67’s Limited Partnership, LRLP, LSLP and Ottawa REDBLACKS Limited Partnership. A sample of 10 transactions was selected for 2018-2019, eight (8) of which were intercompany transactions. The other two (2) were from the related parties Lansdowne Office Inc. and Minto Properties Inc. An additional (3) transactions were selected from EY’s sample to conduct a verification of the validity of transactions from the period of 2012-2017. Overall, the validity[64] of 62% (e.g. 8/13) of transactions could not be assessed due to limitations and gaps in the available supporting documentation.

Of the sample of intercompany transactions, it was found that two (2) transactions ($1,351,111.13 and $1,617,514.00), for a total of $2,968,625.13, were related to a reconciliation of HST amounts between the Component Limited Partnerships and LMLP. This reconciliation occurred based on the advice and analysis completed by KPMG. While these transactions were verified and confirmed to have occurred, the validity of these transactions could not be assessed due to a lack of supporting documentation.

A $37,666.66 transaction was found to be an allocation of over-head costs from LSLP to the Fury, to cover their portion of these costs. Upon discussions with OSEG, it was found that allocations of overhead costs between non-arm length entities are done on the basis of "reasonableness". OSEG completes an analysis to determine the annual overhead costs that will be allocated to the entities during the annual budget process and divides this allocation for a monthly distribution. However, OSEG's process was found to be undocumented and therefore, there is no evidence available to support the methodology used. As a result, we could not verify the validity of this transaction.

[64] The validity of transactions was assessed in order to ensure that transactions were relevant, accurately recorded and issued and appropriately authorized.

It was also found that in several cases (e.g. four (4) out of 13 samples), OSEG was not able to provide evidence in support of the explanations provided. For example, a $450,000.00 transaction from LRLP to LMLP was executed to reduce the high balance in the LRLP account managed by Trinity[65]. OSEG noted that these types of transactions occur periodically when excess cash balances get high and are thus transferred to LMLP to reduce the balance. However, there was no supporting documentation available or notes in the financial system to support OSEG's explanation. OSEG also explained that two (2) entries, one being in 2018 for $666,382.85 and the other in 2015 for $900,000.00, for a total of $1,566,382.85, occurred in error. The 2018 entry (e.g. $666,382.85) was stated by OSEG to have been subsequently reversed and confirmed to be accurate upon our review. Conversely, the 2015 entry (e.g. $900,000.00) was confirmed by OSEG to have been executed to correct previous erroneous accounting entries and no supporting documentation was available, nor was a description included in the accounting system to explain the entry. However, Senior Vice President – Finance & Technology from OSEG confirmed that these balances have been audited to ensure there were no errors. He was also able to confirm that the prior OSEG CFO recalled that this entry was to correct an error. Although both entries were found to be corrected, this illustrates weaknesses in OSEG's account practices and highlights some risks, as the reported financial results directly impact the distributions in the Waterfall.

Furthermore, in relation to one (1) of the transactions selected from EY's sample, it was found that for a single invoice processed and paid in 2013, there were a total of 12 entries valued at $583,135.92 that were completed in error and subsequently corrected, for a total of 24 entries. Source documentation to support this transaction, between OSEG and LMLP, was not immediately available.

The degree to which we observed accounting entry errors and the corresponding correcting entries, poor recordkeeping and lack of documented explanations further supports the recommendations made in this report. Although Audited Financial Statements are provided to the City each year, they focus on the adherence of accounting practices to accounting standards and look for material errors and misstatements. As a result, financial audits may not necessarily identify issues relating to the appropriateness of accounting entries in relation to legal agreements and/or sound operational decisions, which is an important consideration in the City's review

[65] Trinity is the company hired by OSEG as the Property Managers for Lansdowne Park.

and reconciliation in the accounting for and reporting of LMLP's financial position and subsequently, their ability to substantiate non-arm's length financial transactions.

Conclusion

The City has implemented a process for a general review of the non-arm's length transactions as part of the year-end review process, however this verification is simply a reasonability check of year-over-year changes of the related parties' line item in the Financial Statement. The year-end review process does not include specific validating and monitoring activities at the transactional level on a regular basis. The transactional level review performed by EY as part of the Specified Procedures engagement, mitigates some of the risks. However, this was the first time such an analysis was undertaken.

The City has however identified that there will be a process going forward to identify and monitor non-arm's length transactions at the detailed transactional level during the year-end review process, yet this would simply be done if an unreasonable variance was found year-over-year.

Furthermore, we were able to assess the value of the sample of non-arm's length transactions with the documentation provided and no material variances were found in the dollar amounts. However, the validity of these transactions could not be assessed for 62% (e.g. 8/13) of transactions, valued at $10,987,534.33, due to limitations and gaps in the supporting documentation available.

Specifically, there is a lack of formal guidance with respect to the treatment of non-arm's length transactions in relation to the procurement of goods and services from external entities and in the allocation of costs/expense between internal entities. Furthermore, OSEG's tendency to exclude detailed descriptions and lack of documentation supporting entries in their financial system and the lack of any formal guidance in relation to the management of non-arm's length transactions (i.e. Procurement Policy or Guidelines) amplify the challenges relating to clearly understanding and reconciling the non-arm's length transactions. Both of these issues made it difficult to conduct a comprehensive analysis and assess and conclude on the validity of the transactions.

Recommendation 11 – Enhanced comprehensive non-arm’s length transactions review and monitoring processes

It is recommended that the City enhance their current monitoring process of non-arm’s length transactions and establish a predetermined material amounts that trigger further investigation should a material difference from the previous year’s financial results be found during the year-end review process. This process should be documented, have identified a responsible party, an accountable reviewer and approver and the results of the review should be documented and filed in a standard template. The results and recommendations following the review should be communicated to OSEG and any areas of deemed concern should be highlighted and errors should be corrected within predetermined timelines defined by the City. Moreover, the City should conduct a second and final review of these areas of concern the following year to ensure any outstanding risks to the City have been effectively mitigated and issues addressed. As part of this process, the City should also assess the validity of a sample of non-arm's length transactions on an annual basis. This will ensure the City is consistently up to date on these transactions at the detailed level and address any issues quickly and efficiently to ensure there are no longer-term impacts on the distributions and pro forma.

Appendix 1 – List of acronyms, abbreviations and terms

The Audit of Lansdowne Accounting/Waterfall refers to the following acronyms, abbreviations and terms:

Additional Equity: Equity contributed by OSEG in excess of their Minimum Equity requirement.

Agreed Avoided Costs: The cost for which the City and OSEG agree is the amount of annual expenses related to the Stadium that would otherwise be payable by the City had LMLP not existed (e.g. Stadium Lease and Stadium improvements).

Assets: Includes the Stadium, Parking and Retail components.

City Funding Equity: A calculation of the cost borne by the City at the closing date (October 2012) or the initiation of LMLP. This includes the lesser of the Maximum City Cost or the actual cost borne by the City for the Stadium Improvements and the City's share of the costs for the Parking Structure and minus the Deemed Debenture Financing and $7,716,879 for the Air Rights.

Deemed Equity: The credit to be received by the City for the Fair Market Value of the Retail Component lands (excluding any improvements made and paid for by the tenant under the Retail Lease).

EY Specified Procedures: The City engaged EY to conduct specified procedures related to the Lansdowne Master Limited Partnership Waterfall calculations from 2012-2017.

Fair Market Value: The most probable price estimated in terms of money for which land (e.g. land, building, and other improvements) would bring if exposed for sale in the open market by a willing seller.

FEDCO: Finance and Economic Development Committee

Half-year Method: When additions were assumed to have been contributed evenly through the year, therefore the interest was calculated on the beginning balance plus 50% of the additions.

LMGP: Lansdowne Master GP Inc.

LMLP: Lansdowne Master Limited Partnership

LPP: Lansdowne Partnership Plan

LRLP: Lansdowne Retail Limited Partnership

LSLP: Lansdowne Stadium Limited Partnership

Maximum City Costs: The maximum amount the City can pay in relation to the construction of the Parking structure and Stadium improvements (e.g. $135,800,000).

Minimum Equity Requirement: The $30,000,000 in equity required to be contributed by OSEG at the closing date (October 2012) or the initiation of LMLP.

Non-arm's Length: Two (2) entities in a business deal, where the entities do not act independently without one party influencing the other.

OSEG: Ottawa Sports and Entertainment Group

Pro forma: A financial update of the 30-year projections.

P3: Public Private Partnership

Initial Retail Value: The value of the Retail Component at Closing, which is $23,750,000.

Retail Value: The value of the Retail Component to be re-established on the fifth (5th) anniversary of the Operating Term Commencement Date and every five (5) years until the end of the partnership.

TDM: Transportation Demand Management

Unitholder Meeting: Unitholder is defined as investor who owns one or more units of a master limited partnership. As per the Master Limited Partnership Agreement, the General Partner must convene annual Unitholder Meetings within 180 days of the end of each fiscal year to review budgets and strategies.

Appendix 2 – List of related parties

As part of EY's specified procedures engagement in 2019, the following 18 related parties were identified.

No.	Related parties
1	Minto
2	Minto Properties Inc.
3	Trinity Development
4	Ottawa Sports and Entertainment Group
5	Ottawa Sports and Entertainment Group Inc.
6	Ottawa FC Limited
7	Friarmere Holdings Inc
8	Shenkman Lansdowne Ltd
9	Lansgreen Investments Inc
10	Keljay Ltd
11	Trinity Lansdowne Ltd
12	OSEG Foundation
13	Lansdowne Office Inc.
14	Lansoff Holdings Inc.
15	Lansoff Limited Partnership
16	6032796 Canada Inc.
17	Ottawa FC Limited Partnership Interco
18	OSEG Interco

Appendix 3 – Recommendations and management responses

Table 7: Recommendations, management responses and target dates

OAG recommendation	Management response	Target date
Recommendation 1 – Notes on basis of allocation and assumptions used in forecast It is recommended that City increase the level of detail in their annual analyses to a level sufficient to identify and assess material variance at the account level and that they work with OSEG to include notes in the pro forma and Waterfall Schedule indicating the basis of allocation and assumptions used in the forecast. This would also ensure that Council is provided with a greater level of detail and assurance on the reported pro forma and forecasted outlook.	Management agrees with this recommendation. Management will ensure that OSEG provides the level of detail previously provided in the 2016 reconciliation and variance analysis of budget to actual and basis of assumptions in forecasts. This will begin Q3 2021 as these are provided 120 days after fiscal year end of March 31.	Q3 2021
Recommendation 2 – Risk assessment of long-term objectives and financial risks It is recommended that the City conduct a thorough risk assessment of the long-term objectives related to the LMLP and its contractual obligations under the related agreements and develop mitigation strategies to ensure that the City effectively	Management agrees with this recommendation. Long-term and financial risks of the overall partnership should be an integral part of the partnership unitholder's meeting. A risk registry will be developed to inform and guide these discussions by Q3 2021.	Q3 2021 (dependent on partner's meeting)

OAG recommendation	Management response	Target date
manages and monitors these risks.		
Recommendation 3 – Mitigation controls and activities review The City should conduct a review of the controls and activities designed to mitigate risks and implement these controls to ensure a pro-active approach to risk mitigation. For example, identifying specific individuals/roles responsible for managing risks and ensure that those individuals are aware of their roles and responsibilities relating to the management and mitigation of risks. This includes but is not limited to developing clear action plans and providing regular updates to illustrate risk trends over time.	Management agrees with this recommendation. An operational risk register for the Lansdowne Partnership has been developed by RCFS. City departments, including RCFS, CMO, Finance, PIED, Transportation Services and Legal Services, will work collaboratively to manage the Lansdowne risk register. For each risk register item, the respective department(s) will identify the work unit responsible for mitigation measures and will provide updates, which may include mitigation controls and activities, as required.	Q3 2021
Recommendation 4 – Enhanced financial results review and monitoring processes It is recommended that the City enhance and optimize their annual and quarterly financial results review and monitoring processes to include the following: • The validation that key sections within the LMLP financial statements are accounted for accurately and agree with Agreement	Management agrees with this recommendation. Finance will identify key agreement terms of an operational nature that would have an impact on net cashflow, equity contributions and non-arm's length transactions and ensure that they reflected as intended in the financial results. Finance will conduct an analysis of the proforma forecasts on an annual basis comparing it to the 2012 forecast.	Q3 2021

OAG recommendation	Management response	Target date
terms (e.g. Net Cash Flow, Additional Equity contributions, Return on Equity, Non-Arm's Length Transactions are calculated in accordance with the agreement). • An independent validation of the pro forma financial forecasts as of 2020 and use the results of this analysis to compare it to the Original and/or Updated pro forma Financial Forecasts to identify the variances between the 2010 and/or 2015 forecasts and today's current state. • As part of the monitoring activities, that is married to the review processes, develop and implement enhanced controls to ensure the review process is followed consistently and develop comprehensive templates to document and track high risk areas such as additional equity, operating revenues, operating costs and Lifecyle spending year-over-year. These processes should be documented through a standardized process, reported on in a consistent manner, and finally	Finance will document the annual financial results review and monitoring process implementing this by Q3 2021.	

OAG recommendation	Management response	Target date
approved by the City Treasurer's office and filed with the audited Financial Statements.		
Recommendation 5 – Return on investment assessment It is recommended that Corporate Finance conduct an assessment of return on investment (e.g. value for money) to verify if expectations for outcomes are still in line with the original value proposition and/or the current updated expectations. We recommend that this assessment be conducted every 10 years (e.g. three (3) times during the lifecycle of LMLP).	Management agrees with this recommendation. An assessment of the return on investment will be conducted every 10 years, beginning in Q4 2024, to verify that expectations for outcomes are still in line with the original value proposition and/or the current updated expectations.	10 years from start date in 2014: Q4 2024
Recommendation 6 – Detailed review of additional equity contributions It is recommended that the City complete a detailed review of the additional equity contributions and repayments received from and made to OSEG. The impact on the Waterfall resulting from changes to the additional equity amounts can be significant. The City should feel confident that the additional equity contributions and repayments are being made in a fiscally responsible manner and in	Management agrees with this recommendation. There could be an alternative interpretation regarding the $23.5 million transaction. The City and OSEG have now discussed the treatment of the $23.5 million that was funded through a city-guaranteed loan to the Partnership and which resulted in a distribution by the Partnership. OSEG agrees, and does not contest, that the entire amount (including the $6.5 million) could be treated as a return of equity. Although this is contrary to the application of the waterfall distribution methodology in the Partnership, it is consistent with the	Q4 2021

OAG recommendation	Management response	Target date
accordance with the LPP agreements.	spirit of the agreement between the two parties at the time and results in the best outcome for the City. It will be corrected by Q4 2021.	
Recommendation 7 – Calculations of interest reconciliation The City should work with OSEG to ensure that the calculations of interest are reconciled, and that the Waterfall and the Statement of Cash Flows accurately reflect the appropriate calculations for interest/return on equity.	Management agrees with this recommendation and confirms that there is already a process in place to do this. A review was completed in Q2 2020 and the next review will be conducted in Q4 2024.	Completed Q2 2020. Next review to be started in Q4 2024.
Recommendation 8 – Monthly net cash flow calculations It is recommended that the City requests a monthly breakdown of Net Cash Flow actuals from OSEG as part of their year-end financial package. The City should conduct a detailed variance analysis of the monthly breakdown against the reported amounts in the Statement of Cash flow. Should any material variances be found, the City should request additional commentary and supporting documentation from OSEG to support and explain the variance(s).	Management agrees with this recommendation. Beginning in Q3 2021, Finance will ensure that OSEG provides a monthly breakdown of net cashflows as part of the year-end reporting.	Q3 2021

OAG recommendation	Management response	Target date
Recommendation 9 – Documented calculation of interest process and independent reconciliation exercise It is recommended that the City request that OSEG provide a detailed breakdown of the interest calculation process and use this documentation to conduct an independent reconciliation on an annual basis of the interest calculations performed by OSEG in the closed Waterfall system. This independent reconciliation process should be documented, have identified a responsible party, accountable reviewer and approver and results of the review should be documented and filed in a standard template.	Management agrees with this recommendation. Beginning in Q3 2021, management will request documentation from OSEG on the interest calculation methodology and process used. Finance will maintain a separate worksheet to replicate the interest calculation based on the methodology used and will reconcile to the interest calculations provided by OSEG in the proforma annually.	Q3 2021
Recommendation 10 – Verification of the City's deemed equity contributions It is recommended that the City validate that the agreed upon Deemed Equity amount of $23.75M is accurately reflected in the Waterfall and that the City work with OSEG to re-establish the Retail Value of the Land as of February 2020 and update the Waterfall accordingly. The City should also ensure that the Retail Value of the Land is re-established	Management agrees with this recommendation. The Deemed Equity amount of $23.75M has been validated and is accurately reflected in the Waterfall account. Management agrees with the re-establishment of the Retail Value of the Land prior to the agreed upon date in the contract. The City is aware of the upcoming deadline, has already begun the re-establishment process.	

OAG recommendation	Management response	Target date
every five (5) years thereafter (i.e. February 2025, 2030, 2035 etc. in accordance with Section 4.4(b) of the Master Limited Partnership Agreement.		
Recommendation 11 – Enhanced comprehensive non-arm’s length transactions review and monitoring processes It is recommended that the City enhance their current monitoring process of non-arm’s length transactions and establish a predetermined material amounts that trigger further investigation should a material difference from the previous year’s financial results be found during the year-end review process. This process should be documented, have identified a responsible party, an accountable reviewer and approver and the results of the review should be documented and filed in a standard template. The results and recommendations following the review should be communicated to OSEG and any areas of deemed concern should be highlighted and errors should be corrected within predetermined timelines defined by the City. Moreover, the City should conduct	Management agrees with this recommendation. The City will review a sample of all related party transactions reported in the LMLP Financial Statements. Implementation will begin in Q3 2021 and will continue on an annual basis. A detailed review of all potential non-arm’s length transactions will be included in the external review of the equity contributions and waterfall reconciliation to be conducted every 5 years. The next review is scheduled for Q4 2024.	Review of related party transactions Q3 2021 Detailed review of non-arm’s length transactions completed Q2 2020. Next review to be started in Q4 2024.

OAG recommendation	Management response	Target date
a second and final review of these areas of concern the following year to ensure any outstanding risks to the City have been effectively mitigated and issues addressed. As part of this process, the City should also assess the validity of a sample of non-arm's length transactions on an annual basis. This will ensure the City is consistently up to date on these transactions at the detailed level and address any issues quickly and efficiently to ensure there are no longer-term impacts on the distributions and pro forma.		

Appendix 4 – About the audit

Audit objectives and criteria

The overall objective of the audit is to assess whether the City's internal accounting processes for the Waterfall agreement between the City and OSEG are designed and operating effectively and that all components of the City's equity contributions or return on equity are accurately recorded in the Waterfall in accordance with the LPP agreement.

This overall objective was comprised of the following five (5) audit objectives.

Audit objective 1

Assess whether the City's business planning, risk management, performance measurement and reporting for the LPP.

Criteria:

- The City has been involved in the LMLP's business planning activities and the outcomes of this planning have been accurately reflected in the Waterfall budget and forecasts.
- A risk management process is in place to identify and mitigate risks associated with the LPP.
- A process is in place to monitor, analyze, and challenge financial results against the intended outcomes of the LPP.
- The performance measurement and reporting processes to senior management are detailed, accurate and timely.

Audit objective 2

Assess the City’s accounting processes, Equity and Return on Equity.

Criteria:

- City accounting treatments for the LPP and/or LMLP are aligned with the legal structure and substance of partnership agreements and are in accordance with Public Sector Accounting Standards (PSAS).
- The City's internal accounting processes are effectively designed and implemented to ensure that all components of City's equity contributions and return on equity are accurately recorded in the City's accounting systems.

Audit objective 3

Assess OSEG’s accounting for their share of Equity and Return on Equity.

Criteria:

- All components of OSEG's share of equity and return on equity are fair, accounted for, and classified in accordance with the LPP agreements.

Audit objective 4

Assess the City’s monitoring and oversight of Waterfall Distribution System.

Criteria:

- The City is actively monitoring and validating the amounts, calculations, and distributions in the Waterfall Distribution System to ensure they are fair, complete, accurate, and timely.
- All components of the City's equity contributions and return on equity have been accurately recorded in the Waterfall Distribution System in accordance with the LPP agreements.

Audit objective 5

Assess the City's monitoring of Non-Arm's length, revenue and expense transactions.

Criteria:

- The City has identified and is actively monitoring non-arm's length transactions to ensure that the transactions have been treated in accordance with the LPP agreements.

Scope

The scope of this audit includes accounting processes for the Waterfall agreement between the City and OSEG for the period between 2012 and 2019, including:

- Fairness, completeness, and accuracy of City funding equity, OSEG Equity contributions, Return on equity, and distributions to partners;
- Non-Arm's Length, revenue and expense transactions that may have an impact on the determination of equity and/or cash flows; and
- Assessing the accounting treatment of the LPP and/or LMLP in the City of Ottawa financial statements.
- The scope of the audit excludes:
- An audit of LPP agreements or the financial statements of the City, OSEG, LMLP or Lansdowne Master GP Inc.

Audit approach and methodology

The Office of the Auditor General follows a modified version of the International Standards for the Professional Practice of Internal Auditing. The Standards require that sufficient and appropriate audit procedures be conducted, and that evidence be gathered to provide reasonable assurance of the accuracy of audit findings and conclusions, as they existed at the time of the audit.

The audit methodology included the following activities:

- Conducted interviews with City management and staff with responsibilities for managing the agreements between the City and OSEG;
- Reviewed relevant documentation (e.g. Agreements between the City and OSEG, LPP Annual Reports to the Finance and Economic Development Committee and Council, Consolidated Financial Statements of the Lansdowne Master Limited Partnership, City Waterfall Schedules, etc.)
- Testing/reperformance of financial calculations (e.g.: Net Cash Flow calculations).

The audit fieldwork was substantially completed from February – August 2020.

Acknowledgement

The team responsible for this audit, comprised of Sonia Brennan from the Office of the Auditor General and Raymond Chabot Grant Thornton (RCGT) Consulting Inc under the supervision of Sonia Brennan, Deputy Auditor General and the direction of Ken Hughes, Auditor General, would like to thank those individuals who contributed to this project, and particularly, those who provided insights and comments as part of this audit.

Original signed by:

Auditor General