

AUDIT

The Corporation of the City of Hamilton

Audit Findings Report

For the year ended December 31, 2013

KPMG LLP, Licensed Public Accountants

kpmg.ca

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Executive summary

Overview

The purpose¹ of this Audit Findings Report is to assist you, as a member of the Audit, Finance and Administration Committee, in your review of the results of our audit of the consolidated financial statements of the Corporation of the City of Hamilton ("the City") as at and for the year ended December 31, 2013.

We appreciate the assistance of management and staff in conducting our audit. We hope this audit findings report is of assistance to you for the purpose above, and we look forward to discussing our findings and answering your questions.

Status

As of the date of this report, we have completed the audit of the financial statements, with the exception of certain remaining procedures which include:

- obtaining updates for legal matters and subsequent events
- completing our discussions with the Audit, Finance and Administration Committee;
- obtaining evidence of Council's approval of the financial statements; and
- receipt of signed management representation letter

Please refer to the Appendices for our draft auditors' report. We will update you on significant matters, if any, arising from the completion of the audit, including completion of the above procedures. Our auditors' report will be dated upon completion of any remaining procedures and the final approval of the financial statements by Council.

¹ This Audit Findings Report should not be used for any other purpose or by anyone other than the Audit, Finance and Administration Committee. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this Audit Findings Report has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Significant audit, accounting and reporting matters

Included in this report are significant matters we have highlighted for discussion at the upcoming Audit, Finance and Administration Committee meeting. We look forward to discussing these matters and our findings with you.

Changes from the Audit Plan

There have been no changes from the Audit Planning Report previously presented to you.

Matters related to management's judgment and estimates

We have highlighted below significant matters related to management's judgment and estimates that we would like to bring to your attention:

US Steel Tax allowance
<ul style="list-style-type: none">• Management estimates the allowance for tax rebates to US steel based on 25% of total municipal tax levied on US Steel Canada Inc. from 2009 to 2013.• Reliance is placed on assessed value of the property provided by MPAC
KPMG comments regarding effect on the audit
<ul style="list-style-type: none">• Obtained the most recent MPAC statement of issues which indicates the property is over valued by 19% of its value• Assessed the assumptions used in the setting up the allowance based on a review of recent appeals and settlements• Determined that the allowance is reasonable.

Solid waste landfill liabilities
<ul style="list-style-type: none"> • The City owns and operates one open landfill site and owns and monitors 12 closed landfill sites. The present value of the expected closure and post closure care costs of the open landfill site and the present value of expected monitoring and post closure care costs of the closed landfill sites have been reported as a liability on the consolidated statement of Financial Position. • The liability for these future expenses has been estimated by Management.
KPMG comments regarding effect on the audit
<ul style="list-style-type: none"> • Obtained a copy of the most recent estimate calculation for this liability and evaluated management's assumptions and tested calculations. • Verified cost estimates to supporting documentation and found some costs estimates unsupported • Expanded sample for further testing.
Misstatements
<ul style="list-style-type: none"> • The estimated liability was understated by \$2.7 million. See representation letter for summary of audit misstatements
Government Transfers
<ul style="list-style-type: none"> • The new Public Sector Accounting Standard for Government Transfers is effective for fiscal periods beginning on or after April 1, 2012. As a result it is effective for the City commencing the December 31, 2013 year end. • The standard includes specific requirements which impacts the timing of revenue recognition for certain government transfers. It also requires the City to review any contracts prior to the implementation of this standard to determine when revenue will be recognized and if a liability or deferred revenue should be recorded.
KPMG comments regarding effect on the audit
<ul style="list-style-type: none"> • Reviewed the various government transfers in light of the new standard to determine if a liability exists at year end based on stipulations within each agreement. • The accounting policy note related to government transfers has been revised and the notes to the Financial Statements include a note related to the change in accounting.
Tax revenue
<ul style="list-style-type: none"> • On January 1, 2013 the Corporation adopted Public Sector Accounting Standards PS 3510, <i>Tax revenue</i>. • This standard was adopted on a prospective basis from the date of adoption. • Under this standard, taxes receivable and tax revenue are recognized when they meet the definition of an asset, the tax is authorized and the taxable event has occurred.
KPMG comments regarding effect on the audit
<ul style="list-style-type: none"> • Discussed the adoption of this new standard through inquiry with management • Reviewed recognition and measurement requirements of the standard. • No changes in revenue recognition resulted from this standard

Development charges
<ul style="list-style-type: none">• Development charges received are externally restricted by provincial legislation• Development charges must used for the purpose for which they are collected• Revenue should be recognized when funds are spent on the purpose for which they are collected.
KPMG comments regarding effect on the audit
<ul style="list-style-type: none">• In some instances, revenue was recognized prior to collecting the development charge• In some instances, revenue was recognized prior to spending the funds
Misstatements
<ul style="list-style-type: none">• Development charges earned were overstated
Public liability insurance
<ul style="list-style-type: none">• Management has accrued liability relating to outstanding insurance claims for the portion borne by the City.• Management has accrued an amount for each claim based upon the likelihood of payout on the claim.
KPMG comments regarding effect on the audit
<ul style="list-style-type: none">• Obtained the detailed listing of claims and recalculated the insurance liability on a test basis.• Reviewed the criteria used for the accrual with Risk Management staff to determine compliance with PSAB standards.• Discussed with management cases that had a significant increase in claim costs compared to previous periods, any unusual cases or events, and the process for monitoring and managing the risks.

Significant qualitative aspects of accounting policies and practices

Our professional standards require that we communicate our views regarding the matters below, which represent judgments about significant qualitative aspects of accounting policies and practices. Judgments about quality cannot be measured solely against standards or objective criteria. These judgments are inherently those of the individual making the assessment: the engagement partner. However, although judgments about quality are those of the engagement partner, the views discussed below are not contrary to positions KPMG has taken.

The following are the matters we plan to discuss with you:

<p>Significant accounting policies</p>	<p>Significant accounting policies or practices are disclosed in Note 1 to the financial statements.</p> <p>The following new or revised significant accounting policies or practices were selected and applied during the year</p> <ul style="list-style-type: none"> • Government transfers • Tax revenue • The accounting policies are appropriate to the particular circumstances of the City. <p>The City has applied the remaining significant accounting policies consistently on a year to year basis.</p>
<p>Critical accounting estimates</p>	<p>Critical accounting estimates include the employee future benefits and other obligations, solid waste landfill liability, and donated tangible assets and are disclosed as such in Note 1 (c) to the financial statements</p> <ul style="list-style-type: none"> • The approach to estimating solid waste landfill liability was reviewed and revised this year to provide a more robust process for estimating this liability • The same approach has been used to value the employee future benefits and other obligations and donated tangible assets.
<p>Critical disclosures and financial statement presentation</p>	<p>The financial statements include disclosures and presentation requirements under the relevant financial reporting framework.</p>

Misstatements

Identification of misstatements

Misstatements identified during the audit have been categorized as follows:

- corrected misstatements, including disclosures
- uncorrected misstatements, including disclosures.

Corrected misstatements

The representation letter in the Appendices includes all corrected misstatements communicated to management identified as a result of the audit procedures performed.

Uncorrected misstatements

There are no uncorrected audit misstatements.

Control deficiencies

Background and professional standards

As your auditors, we are required to obtain an understanding of internal control over financial reporting (ICFR) relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on internal control. Accordingly, we do not express an opinion on the effectiveness of internal control.

Our understanding of ICFR was for the limited purpose described above and was not designed to identify all control deficiencies that might be significant deficiencies and therefore, there can be no assurance that all significant deficiencies and other control deficiencies have been identified. Our awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

Identification

We did not identify any control deficiencies that we determined to be significant deficiencies in ICFR.

Documents containing or referring to the audited financial statements

KPMG not engaged to consent to the use of our auditors' report

We are required by our professional standards to read only documents containing or referring to audited financial statements and our related auditors' report that are available through to the date of our auditors' report. The objective of reading these documents through to the date of our auditors' report is to identify material inconsistencies, if any, between the audited financial statements and the other information. We also have certain responsibilities, if on reading the other information for the purpose of identifying material inconsistencies, we become aware of an apparent material misstatement of fact.

Accordingly, as of the date of this Audit Findings Report, we have read the following documents containing, or incorporating by reference, the audited financial statements and our related auditors' report:

- 2013 Financial Report

There are no unresolved matters to report as a result of reading the above documents as of the date of this Audit Findings Report.

Should other such documents become available prior to the date of our auditors' report we will communicate any unresolved matters, if any, at such time.

Appendices

Independence letter

Management representation letter

Other current developments

Independence letter



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PRIVATE & CONFIDENTIAL

The Members of the Audit, Finance and Administration Committee
City of Hamilton
71 Main Street West
Hamilton, Ontario L8P 4Y5

May 16, 2014

Ladies and Gentlemen:

Professional standards specify that we communicate to you in writing, at least annually, all relationships between The Corporation of the City of Hamilton ("the Municipality") (and its related entities) and our firm, that may reasonably be thought to bear on our independence.

In determining which relationships to report, we are required to consider relevant rules and related interpretations prescribed by the Institute of Chartered Accountants of Ontario and any applicable legislation or regulation, covering such matters as:

- a) provision of services in addition to the audit engagement
- b) other relationships such as:
 - holding a financial interest, either directly or indirectly, in a client
 - holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client
 - personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client
 - economic dependence on a client.



PROVISION OF SERVICES

The following summarizes the professional services rendered by us to the Municipality (and its related entities) from January 1, 2013 up to the date of this letter:

Description of Service
<p data-bbox="228 411 792 443">Audits for the year ended December 31, 2013</p> <ul data-bbox="228 478 1292 1010" style="list-style-type: none"> • The Corporation of the City of Hamilton • Hamilton Public Library • Global Spectrum • CityHousing Hamilton • CANUSA Games • Hamilton Renewable Power Incorporated • Hamilton Utilities Corporation • City of Hamilton Trust Funds – various • City of Hamilton Pension Plans – various • City of Hamilton Business Improvement Areas – various • Provincial Offences Administration • Mohawk 4Ice Centre • Canadian Football Hall of Fame and Museum • Program funding audits for various provincial Ministries and the Federal Government • Compliance audit of the Transfer of Federal Gas Tax Revenues <p data-bbox="228 1066 740 1098">Other audit and non audit services billed</p> <ul data-bbox="228 1134 1094 1236" style="list-style-type: none"> • Taxation compliance and advisory services • Assistance with financial modeling • Forensic Data Analytics for procurement process at Horizon Utilities

Professional standards require that we communicate the related safeguards that have been applied to eliminate identified threats to independence or to reduce them to an acceptable level. Although we have policies and procedures to ensure that we did not provide any prohibited services and to ensure that we have not audited our own work, we have applied the following safeguards regarding the threats to independence listed above:

- We did not assume the role of management by instituting policies and procedures to prohibit us from making management decisions or assuming responsibility for such decisions
- We obtained management's acknowledgement of responsibility for the results of the work performed by us regarding non-audit services and we have not made any management decisions or assumed responsibility for such decisions

OTHER RELATIONSHIPS

We are not aware of any other relationships between our firm and the Municipality (and its related entities) that may reasonably be thought to bear on our independence up to the date of this letter.



CONFIRMATION OF INDEPENDENCE

We confirm that we are independent with respect to the Municipality (and its related entities) within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of the date of this letter.

OTHER MATTERS

This letter is confidential and intended solely for use by those charged with governance in carrying out and discharging their responsibilities and should not be used for any other purposes.

KPMG shall have no responsibility for loss or damages or claims, if any, to or by any third party as this letter has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Yours very truly,

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a single horizontal line that starts under the 'K' and ends under the 'P'.

Chartered Accountants, Licensed Public Accountants
Lois Ouellette
Partner
(905) 687-3276

Management representation letter

KPMG LLP
Chartered Accountants
Commerce Place
21 King Street West, Suite 700
Hamilton, Ontario L8P 4W7
Canada

June 9, 2014

Ladies and Gentlemen:

We are writing at your request to confirm our understanding that your audit was for the purpose of expressing an opinion on the consolidated financial statements (hereinafter referred to as "financial statements") of The Corporation of the City of Hamilton ("the Entity") as at and for the period ended December 31, 2013.

We confirm that the representations we make in this letter are in accordance with the definitions as set out in **Attachment I** to this letter.

We confirm that, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

GENERAL:

- 1) We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated November 12, 2012, for:
 - a) the preparation and fair presentation of the financial statements and believe that these financial statements have been prepared and present fairly in accordance with the relevant financial reporting framework
 - b) providing you with all relevant information, such as all financial records and related data and complete minutes of meetings, or summaries of actions of recent meetings for which minutes have not yet been prepared, of council and committees of council that may affect the financial statements, and access to such relevant information
 - c) such internal control as management determined is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error

- d) ensuring that all transactions have been recorded in the accounting records and are reflected in the financial statements

INTERNAL CONTROL OVER FINANCIAL REPORTING:

- 2) We have communicated to you all deficiencies in the design and implementation or maintenance of internal control over financial reporting of which management is aware.

FRAUD & NON-COMPLIANCE WITH LAWS AND REGULATIONS:

- 3) We have disclosed to you:
 - a) the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud
 - b) all information in relation to fraud or suspected fraud that we are aware of and that affects the Entity and involves: management, employees who have significant roles in internal control, or others, where the fraud could have a material effect on the financial statements
 - c) all information in relation to allegations of fraud, or suspected fraud, affecting the Entity's financial statements, communicated by employees, former employees, regulators, or others
 - d) all known instances of non-compliance or suspected non-compliance with laws and regulations, including all aspects of contractual agreements, whose effects should be considered when preparing financial statements
 - e) all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements

SUBSEQUENT EVENTS:

- 4) All events subsequent to the date of the financial statements and for which the relevant financial reporting framework requires adjustment or disclosure in the financial statements have been adjusted or disclosed.

RELATED PARTIES:

- 5) We have disclosed to you the identity of the Entity's related parties and all the related party relationships and transactions of which we are aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the relevant financial reporting framework.

ESTIMATES:

- 6) Measurement methods and significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

NON-SEC REGISTRANTS OR NON-REPORTING ISSUERS:

- 7) We confirm that the Entity is not a Canadian reporting issuer (as defined under any applicable Canadian securities act) and is not a United States Securities and Exchange Commission ("SEC") Issuer (as defined by the Sarbanes-Oxley Act of 2002). We also confirm that the financial statements of the Entity will not be included in the consolidated financial statements of a Canadian reporting issuer audited by KPMG or an SEC Issuer audited by any member of the KPMG organization.

MISSTATEMENTS:

- 8) The effects of the uncorrected misstatements described in **Attachment II** are immaterial, both individually and in the aggregate, to the financial statements as a whole
- 9) We approve the corrected misstatements identified by you during the audit described in **Attachment II**.

Yours very truly,

THE CORPORATION OF THE CITY OF HAMILTON

By: Mike Zegarac, General Manager, Finance and Corporate Services

By: Rick Male, Director, Finance Services and Corporate Controller

By: Tony Del Monaco, Acting Manager of Accounting Services

Attachment I – Definitions

MATERIALITY

Certain representations in this letter are described as being limited to matters that are material. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.

FRAUD & ERROR

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

RELATED PARTIES

In accordance with Canadian public sector accounting standards a *related party* is defined as:

- Related parties exist when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two or more parties are related when they are subject to common control, joint control or common significant influence. Two not-for-profit organizations are related parties if one has an economic interest in the other. Related parties also include management and immediate family members (see paragraph .04).

In accordance with Canadian public sector accounting standards a *related party transaction* is defined as:

- A related party transaction is a transfer of economic resources or obligations between related parties, or the provision of services by one party to a related party, regardless of whether any consideration is exchanged. The parties to the transaction are related prior to the transaction. When the relationship arises as a result of the transaction, the transaction is not one between related parties.

City of Hamilton
 Attachment II
 Summary of Corrected Audit Misstatements
 For Year Ended
 Amounts in **thousands**
 Method Used to (**Income statement method**

ID	Description of misstatement	Accounts	Debit	(Credit)	<u>Income Statement Effect - Debit (Credit)</u>	<u>Balance Sheet Effect - Debit (Credit)</u>
					Income Effect Debit (Credit)	Equity
1	Overstatement of landfill liabilities	Solid waste landfill liabilities	4,410			4,410
		Enviromental services		-4,410	-4,410	
2	Over transfer DC funding to revenue	Deferred revenue - obligatory reserve funds		-68,295		-68,295
		Development charges and subdivider contributions	68,295		68,295	

Other current developments

Public Sector Enterprises

New guidance issued

PS 3260 – Contaminated Sites:

The Liability for Contaminated Sites (PS 3260) section impacts every organization reporting under the Public Sector Accounting (PSA) standards, and the new standards take effect for all organizations with fiscal years beginning on or after April 1, 2014.

Clarifications to guidance:

PS3260 is a new accounting standard that requires public sector organizations with fiscal years starting on April 1, 2014, or later, to report on liabilities at contaminated sites you own, or have assumed responsibility to remediate.

PS3260 impacts federal, provincial, municipal and First Nations governments, as well as Crown corporations, universities, schools and hospitals. If you use Public Sector Accounting Standards (PSAS), PS3260 most likely applies to you.

This is a time-sensitive, regulation driven issue that all organizations reporting under PSAS must address. It's a complex process that will need to be carefully managed. Even if there is no site contamination, this fact must be proven in line with the new accounting standard.

Next Steps:

Public sector entities need to plan now for the introduction of PS 3260 and start to understand how the new standards will impact their reporting responsibilities. Failure to appropriately apply the standards could have negative financial, and potentially political and social ramifications.

Still not sure? Answer the key diagnostic questions below to determine your next steps.

Liability for Contaminated Sites - Key Diagnostic Questions:

- o Are you a public sector entity reporting under the PSA standards?
- o Have you developed an inventory of all sites, both contaminated and not contaminated?
- o Has a formal gap analysis been performed of the entity's existing accounting policies to the requirements of PS 3260?
- o Have you identified all legally binding and enforceable regulations and environmental standards?
- o Are you aware of your reporting requirements, whether or not you have contaminated sites?
- o Are you able to demonstrate the completeness and accuracy of liabilities recorded for contaminated sites to your financial statement auditor?

If you would like a more detailed assessment, we've also created an online self-assessment tool to help you test your readiness to comply with PS 3260 at kpmg.ca/contaminatedsites.

Proposed amendments to PSAB

Exposure Draft: *Financial Instruments: Income on Externally Restricted Assets*

The PSAB recently issued an exposure draft on *Financial Instruments: Income on Externally Restricted Assets* that proposes to amend Section PS 3450, *Financial Instruments*, to ensure the reporting of income on externally restricted assets that are financial instruments aligns with the requirements in Section PS 3100, *Restricted Assets and Revenues*. The proposed amendments clarify the accounting for gains, losses, interest and dividends when income attributable to a financial asset is externally restricted and addresses the accounting for adjustments associated with the transition to Section PS3450 when income attributable to a financial asset is restricted.

PSAB projects underway

The following section discusses the major projects currently with the Public Sector Accounting Board:

Concepts underlying financial performance

The objective of this project is to review and amend, if necessary, the conceptual framework in Sections PS 1000, *Financial Statement Concepts*, and PS 1100, *Financial Statement Objectives*. PSAB's Conceptual Framework Task Force has recently issued a consultation paper that proposes an objective and primary audience for financial reporting, the accountabilities to be reported on in financial statements, and alternative reporting models to demonstrate them.

Other projects underway

The PSAB is currently working on a number of other projects that are in various stages of advancement. Some of the projects currently underway include asset retirement obligations; assets; fiscal sustainability; impairment of non-financial assets; restructurings; revenues and service concession arrangements. Details on these projects can be found on the [PSAB website](#).

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