KPMG
cutting through complexity

AUDIT

City of Hamilton

Audit Planning Report
For the year ending December 31, 2014

KPMG LLP

Licensed Public Accountants

December 15, 2014

kpmg.ca

The contacts at KPMG in connection with this report are:

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At KPMG, we are **passionate** about earning your **trust**. We take deep **personal accountability**, individually and as a team, to deliver **exceptional service and value** in all our dealings with you.

At the end of the day, we measure our success from the **only perspective that matters – yours**.

Executive summary

Audit and business risk

Our audit is risk-focused. In planning our audit we have taken into account key areas of focus for financial reporting. These include:

- Portfolio investments
- Development charges revenue recognition
- Government transfers recognition
- US Steel tax allowance
- Solid waste landfill liabilities
- Employee future benefits
- Tangible capital assets

See page 4 for detailed information

KPMG team

The KPMG team will be led by Lois Ouellette, CPA, CA.

See page 9 for detailed information.

Audit Materiality

Materiality has been determined based on fiscal 2013 total revenues. We have reviewed the scope of work across segments and businesses across the group. We have determined group materiality to be $39.5 million for the year ending December 31, 2014

See page 8 for detailed information.

Effective communication

We are committed to transparent and thorough reporting of issues to the management team and the Audit Committee. We have planned our work to closely co-ordinate and communicate with KPMG partners and offices.

See Appendix 3 for detailed information.

Independence

We are independent and have extensive quality control and conflict checking processes in place. We provide complete transparency on all services.

Risk Assessment

Our planning begins with an assessment of inherent risk of material misstatement in your financial statements. Our assessment is based on a variety of factors that include our knowledge of your business, the market and the susceptibility of the account balance to the risk of material misstatement.

We have not identified any significant risks. The following areas continue to be our focus:

- Portfolio investments and related income
- Tangible capital assets
- Government transfers and development charges revenue recognition
- Expenditures and payables
- Employee future benefits (pension obligation; retirement benefits; long-term disability; sick leave and WSIB)
- Solid waste landfill liabilities
- Tax receivable valuation

Audit approach

Professional standards presume the risk of fraudulent revenue recognition and the risk of management override of controls exist in all companies.

The risk of fraudulent recognition can be rebutted, but the risk of management override of control cannot because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

CAS requirements	Why	Our audit approach
Fraud risk from revenue recognition	This is a presumed fraud risk. We have identified two areas where there is a presumed fraud risk: - Development charges - Government transfers The nature of development charges and their use create complexity in the timing of revenue recognition. Government transfer revenue recognition is dependant on the terms of the grant. The City receives many different types of grants with different terms and conditions.	• Our approach is a substantive approach where we obtain supporting documentation to determine the timing of revenue recognition
Fraud risk from management override of controls	This is a presumed fraud risk. We have not identified any specific additional risks of management override relating to this audit.	As the risk is not rebuttable, our audit methodology incorporates the required procedures in professional standards to address this risk. These procedures include testing of journal entries and other adjustments, performing a retrospective review of estimates and evaluating the business rationale of significant unusual transactions.

Audit approach (continued)

Other areas of focus include the following:

- Portfolio investments and related income
- Tangible capital assets
- Expenditures and payables (including payroll)
- Employee future benefits
- Solid waste landfill liabilities
- Tax receivable valuation

Other areas of focus	Why	Our audit approach
Portfolio investments	Significant asset Valuation involves professional judement	• Substantive approach • Confirmation of balances • Assess valuation
Tangible capital assets	Significant asset Contributed assets	• Evaluate design and implementation of controls over disbursement • Test the operating effectiveness of the controls • Substantive test to confirm treatment as an asset versus expense
Expenditures and payables (including payroll)	Significant component of operating results	• Evaluate design and implementation of controls over disbursement • Test the operating effectiveness of the controls • Substantive test to confirm treatment as expense
Employee future benefits	Significant estimate	• Substantive test over liability balance • Reliance is placed on work of actuary
Solid waste landfill liabilities	Significant estimate Significant assumptions	• Substantive test over liability balance • Testing assumptions for reasonableness and appropriateness
Tax receivable	Valuation of significant receivable could be impaired	• Substantive test of valuation of outstanding tax receivables

Audit approach (continued)

Professional standards require that we obtain an understanding of the City's organizational structure, including its components and their environments, that is sufficient to identify those components that are financially significant or that contain specific risks that must be addressed during our audit.

Group auditors are required to be involved in the component auditors' risk assessment in order to identify significant risks to the group financial statements. If such significant risks are identified, the group auditor is required to evaluate the appropriateness of the audit procedures to be performed to respond to the identified risk.

The components over which we plan to perform audit procedures are as follows:

Components	Why	Our audit approach
Hamilton Utilities Corporation Auditor: KPMG	Individually financially significant	Statutory audit of component financial statements Same audit partner
Hamilton Public Library, Hamilton Street Railway Company, Hamilton Renewable Power Incorporated, CityHousing Hamilton, BIAs, Mohawk 4Ice Centre Auditor: KPMG	Non-significant components; however, necessary to issue group audit opinion	Statutory audit of component financial statements KPMG audit partner and audit team

Materiality

Professional standards require us to re-assess materiality at the completion of our audit based on period-end results or new information in order to confirm whether the amount determined for planning purposes remains appropriate.

Our assessment of misstatements, if any, in amounts or disclosures at the completion of our audit will include the consideration of both quantitative and qualitative factors.

The first step is the determination of the amounts used for planning purposes as follows.

The determination of materiality requires judgment and is based on a combination of quantitative and qualitative assessments including the nature of account balances and financial statement disclosures:

2014 materiality determination	Comments	City
Materiality	Determined to plan and perform the audit and to evaluate the effects of identified misstatements on the audit and of any uncorrected misstatements on the financial statements.	$35,600,000
Performance materiality	Used 75% of materiality, and used primarily to determine the nature, timing and extent of audit procedures.	$26,700,000
Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit.	$1,780,000

Highly talented team

	Team member	Background / experience	Discussion of role
	Lois Ouellette CPA, CA Audit Engagement Partner louellette@kpmg.ca / 906-687-3276	• Lois Ouellette is a partner in our Hamilton/Niagara office and has over thirty years of audit experience serving a number of clients in the public sector and utilities. She has significant experience serving Municipality and hydro utility clients. Lois authored the PSAB Financial Reporting course for the Institute of Chartered Accountants of Ontario (ICAO) and teaches the CPAO's offerings of the PSAB 101 course. Lois's clients include the Regional Municipality of Halton, the Towns of Halton Hills, Milton, Niagara on the Lake and Oakville.	• Lois will lead our audit for the year ended December 31, 2014 and be responsible for the quality and timeliness of everything we do. • She will often be onsite with the team and will always be available and accessible to the City.
	Michelle Fisher, CPA, CA Audit Manager mfisher@kpmg.ca / 905-523-2207	• Michelle is a Manager in our Hamilton office with over 5 years of experience with public sector clients.	• Michelle works very closely with Lois on all aspects of our audit. She will be on site and directly oversee and manage our audit field team and work closely with your management team.

Value for fees

The Value of our Audit Services

We recognize that the primary objective of our engagement is the completion of an audit of the consolidated financial statements in accordance with professional standards. We also believe that our role as external auditor of City of Hamilton and the access to information and people in conjunction with our audit procedures, places us in a position to provide other forms of value. We know that you expect this of us.

We want to ensure we understand your expectations. To facilitate a discussion (either in the upcoming meeting or in separate discussions), we have outlined some of the attributes of our team and our processes that we believe enhance the value of our audit service. We recognize that certain of these items are necessary components of a rigorous audit. We welcome your feedback.

- Extensive industry experience on our audit team – as outlined in our team summary, the senior members of our team have extensive experience in audits of organizations in your sector. This experience ensures that we are well positioned to identify and discuss observations and insights that are important to you;
- Current development update sessions – we have provided management with information on current developments on financial reporting and other matters that are likely to be significant to the City and your team. This information will assist the City in proactively responding / addressing financial reporting;

Value for fees (continued)

Our fees our set out in our audit proposal where we considered the nature, extent and timing of our planned audit procedures as described above. Our fee analysis has been reviewed with and agreed upon by management based upon our most recent proposal.

Matters that could impact our fee

The proposed fees outlined above are based on the assumptions described in the engagement letter.
The critical assumptions, and factors that cause a change in our fees, include:

- Significant changes in the nature or size of the operations of the Organization beyond those contemplated in our planning processes;
- Changes in professional standards or requirements arising as a result of changes in professional standards or the interpretation thereof;
- Changes in the timing of our work;

Audit cycle and timetable

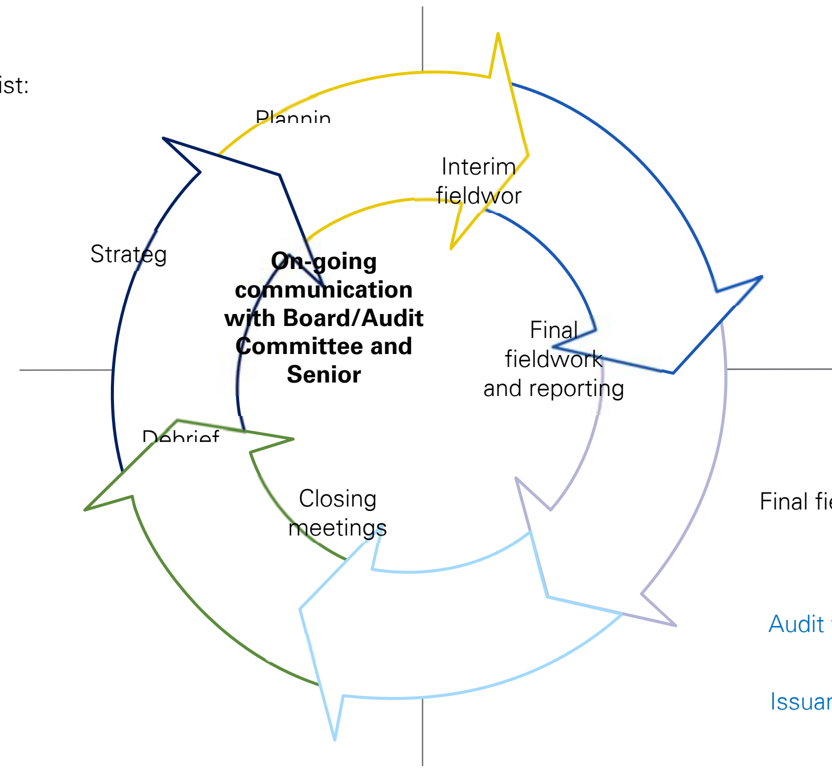
Our key activities during the year are designed to achieve our one principal objective:

To provide a robust audit, efficiently delivered by a high quality team focused on key issues.

Our timeline is in line with prior year, with any significant risks discussed before field work to avoid any last minute surprises.

Planning meeting with management: October 29, 2014

Commence year end planning including information risk management specialist: November, 2014



Final fieldwork: March and April 2015

Closing meetings:

Audit findings discussion: May, 2015

Issuance of Audit Report: June, 2015

Appendices

Appendix 1: Audit Quality and Risk Management

KPMG maintains a system of quality control designed to reflect our drive and determination to deliver independent, unbiased advice and opinions, and also meet the requirements of Canadian professional standards.

Quality control is fundamental to our business and is the responsibility of every partner and employee. The following diagram summarises the six key elements of our quality control systems.

Visit http://www.kpmg.com/Ca/en/services/Audit/Pages/Audit-Quality-Resources.aspx for more information.

- Other controls include:
  - Before the firm issues its audit report, Engagement Quality Control Reviewer reviews the appropriateness of key elements of publicly listed client audits.
  - Technical department and specialist resources provide real-time support to audit teams in the field.
- We conduct regular reviews of engagements and partners. Review teams are independent and the work of every audit partner is reviewed at least once every three years.
- We have policies and guidance to ensure that work performed by engagement personnel meets applicable professional standards, regulatory requirements and

- All KPMG partners and staff are required to act with integrity and objectivity and comply with applicable laws, regulations and professional standards at all times.
- We do not offer services that would impair our independence.
- The processes we employ to help retain and develop people include:
  - Assignment based on skills and experience;
  - Rotation of partners;
  - Performance evaluation;
  - Development and training; and
  - Appropriate supervision and coaching.
- We have policies and procedures for deciding whether to accept or continue a client relationship or to perform a specific engagement for that client.
- Existing audit relationships are reviewed annually and evaluated to identify instances where we should discontinue our professional association with the client.

Appendix 2: KPMG's audit approach and methodology

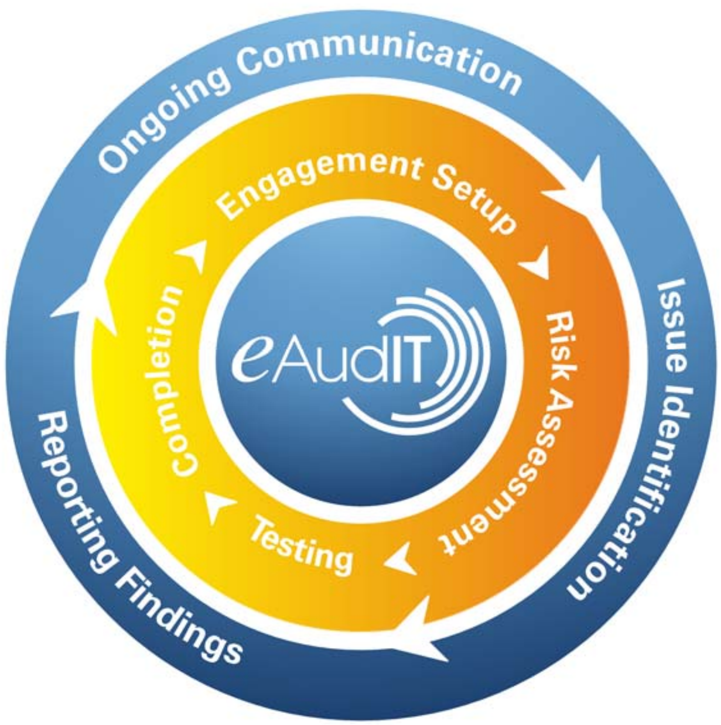
Technology-enabled audit work flow (eAudIT)

Engagement Setup

- Tailor the eAudIT work flow to your circumstances
- Access global knowledge specific to your industry
- Team selection and timetable

Completion

- Tailor the eAudIT work flow to your circumstances
- Update risk assessment
- Perform completion procedures and overall evaluation of results and financial statements
- Form and issue audit opinion on financial statements
- Obtain written representation from management



Risk Assessment

- Tailor the eAudIT work flow to your circumstances
- Understand your business and financial processes
- Identify significant risks
- Plan involvement of KPMG specialists and others including external experts, internal auditors, service organizations auditors and component auditors
- Determine audit approach
- Evaluate design and implementation of internal controls

Testing

- Tailor the eAudIT work flow to your circumstances
- Test operating effectiveness of internal controls (as considered necessary)
- Perform substantive tests

Appendix 3: Required communications

In accordance with professional standards, there are a number of communications that are required during the course of our audit. These include:

- **Engagement letter** – the objectives of the audit, our responsibilities in carrying out our audit, as well as management's responsibilities, are set out in the engagement letter and any subsequent amendment letters as attached
- **Audit planning report** – as attached
- **Fraud related inquiries** – professional standards required that during the planning of our audit we obtain your views on risk of fraud. We make similar inquiries to management as part of our planning process; responses to these will assist us in planning our overall audit strategy and audit approach accordingly
- **Management representation letter** – we will obtain from management at the completion of the annual audit. In accordance with professional standards, copies of the representation letter will be provided to the Audit Committee
- **Audit findings report** – we will provide this report at the completion of our audit to the Audit Committee
- **Annual independence letter** – we will provide this letter at the completion of our audit to the Audit Committee

Appendix 4: Current developments

The following is a summary of the current developments that are relevant to the Organization.

Standard	Summary and implications	Reference
New standard – Liability for Contaminated sites (effective January 1, 2015)	A new standard has been issued, addressing liabilities for remediation related to sites, or parts of a site no longer in active or productive use. This is effective for the fiscal periods beginning on or after April 1, 2014. Implications: This standard requires the entity to record a liability for the continuing remediation efforts related to contaminated sites no longer in active or productive use. Many contaminated sites still require additional analysis to determine the extent of any potential liability which should be recorded. In addition to the lack of information on the contaminated sites, the measurement of environmental liabilities requires substantial professional judgment and can vary widely year to year. How an entity accounts for long term monitoring costs, for example, and the assumptions applied to index and discount future remediation expenditures can materially impact the amount of the liability reported.	
New standard - financial instruments (effective January 1, 2017)	A new standard has been issued, establishing a standard on accounting for and reporting all types of financial instruments including derivatives. This standard is effective for fiscal periods beginning on or after April 1, 2016. Implications: This standard requires the entity to record any equity investments that trade in an active market at market value at fair value. The entity can also elect to record any investments that are managed and evaluated on a fair value basis at fair value. Changes in fair value of all assets recorded at fair market value will be reported in a new financial statement – statement of remeasurement gains and losses. This standard will also require the entity to identify any contracts that have embedded derivatives and recognize these on the statement of financial position at fair value. The standard sets out a number of disclosures designed to give users an understanding of the significance of financial instruments to the entity and to evaluate the risks to the entity.	