



AUDIT

# The City of Hamilton

Audit Planning Report  
For the year ending December 31, 2015



December 8<sup>th</sup>, 2015

[kpmg.ca](http://kpmg.ca)



The contacts at KPMG in connection with this report are:

**Lois Ouellette**

Lead Audit Engagement  
Partner

Tel: 905-687-3276

[louellette@kpmg.ca](mailto:louellette@kpmg.ca)

**Paul Ciapanna, CPA, CA**

Audit Manager

Tel: 905-523-2228

[ppciapanna@kpmg.ca](mailto:ppciapanna@kpmg.ca)

# Table of Contents

<b>Executive summary</b>	<b>3</b>
<b>Audit approach</b>	<b>4</b>
<b>Materiality</b>	<b>7</b>
<b>Highly talented team</b>	<b>8</b>
<b>Value for fees</b>	<b>9</b>
<b>Audit cycle and timetable</b>	<b>11</b>
<b>Appendices</b>	<b>12</b>
<b>Appendix 1: Audit Quality and Risk Management</b>	<b>13</b>
<b>Appendix 2: KPMG's audit approach and methodology</b>	<b>14</b>
<b>Appendix 3: Required communications</b>	<b>15</b>
<b>Appendix 4: Current developments</b>	<b>16</b>

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

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## 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:

- Revenue recognition and deferral policies including grants
- Tangible capital assets
- Employee future benefits liability
- Contaminated sites liability
- Landfill liability
- Investment and related income
- Operating expenditures
- Divestiture of CUP

*See pages 4-6*

## KPMG team

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

*See page 8*

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## Audit Materiality

Materiality has been determined based on prior period total revenues. We have reviewed the scope of work across segments and business units across the group. Materiality will be set at lower thresholds where necessary to meet requirements of various funding agencies. We have determined group materiality to be \$43,300,000 for the year ending December 31, 2015.

*See page 7*

## Effective communication

We are committed to transparent and thorough reporting of issues to senior management and the Audit Committee. We have planned our work closely with your management team.

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## A collective audit approach

We have planned the audit to coordinate our work with our information risk management group to reduce overlap and leverage their work performed. We will continue to liaise regularly and extensively with our information risk management group.

## Independence

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

# Audit approach

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

The risk of fraudulent revenue recognition can be rebutted, but the risk of management override of control cannot, since 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.

## Professional requirements

Fraud risk from revenue recognition

Fraud risk from management override of controls

## Why

This is a presumed fraud risk under Canadian Auditing Standards.

We have identified the following areas where this presumed fraud risk is relevant:

- Government grants
- Development charges

Government grant revenue recognition is dependent on the terms of the grant and can be complex depending upon the terms. The City receives many different types of grants with different terms and conditions.

Fraud could include misapplying expenditures to incorrect grant funded programs in order to maximize returnable funding.

The nature of development charges and their use create complexity in the timing of revenue recognition.

This is a presumed fraud risk. We have not identified any specific additional risks of management override relating to this audit.

## Our audit approach

Our audit approach will consist of performing substantive procedures to determine the timing of revenue recognition.

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

Other areas of focus include the following:

Other areas of focus	Why	Our audit approach
Government Grants	Risk of material misstatement related to the completeness and accuracy of grant revenue	<ul style="list-style-type: none"> <li>Substantive test of timing of revenue recognition</li> </ul>
Tangible Capital Assets	Risk of material misstatement related to the classification, completeness and accuracy of tangible capital assets	<ul style="list-style-type: none"> <li>Evaluate design and implementation of controls over disbursement</li> <li>Test the operating effectiveness of the controls</li> <li>Substantive test to confirm treatment as an asset versus expense</li> </ul>
Employee Future Benefits	Risk of material misstatement related to the completeness and accuracy of the liability and related expenses	<ul style="list-style-type: none"> <li>Substantive test over liability balance</li> <li>Reliance is placed on work of actuary</li> </ul>
Contaminated Sites Liability	Risk of material misstatement related to the completeness and accuracy of the liability and related expenses	<ul style="list-style-type: none"> <li>Substantive test over the completeness and accuracy of the liability</li> </ul>
Landfill Liability	Risk of material misstatement related to the completeness and accuracy of the liability and related expenses	<ul style="list-style-type: none"> <li>Substantive test over the liability balance</li> </ul>
Investments and related income	Risk of material misstatement related to the existence and valuation of investments and accuracy of related income.	<ul style="list-style-type: none"> <li>Substantive approach</li> <li>Confirmation of balances</li> <li>Assess valuation</li> </ul>
Operating expenditures including payroll	Risk of material misstatement related to the completeness, existence and accuracy of expenditures	<ul style="list-style-type: none"> <li>Evaluate design and implementation of controls over disbursement</li> <li>Test the operating effectiveness of the controls</li> <li>Substantive test to confirm treatment as expense</li> </ul>

# Audit approach

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
<b>Hamilton Utilities Corporation</b> <b>Auditor: KPMG</b>	Individually financially significant	Statutory audit of component financial statements
<b>Hamilton Public Library, Hamilton Street Railway Company, Hamilton Renewable Power Incorporated, CityHousing Hamilton, BIAs, Mohawk 4Ice Centre</b> <b>Auditor: KPMG</b>	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 professional judgment and is based on a combination of quantitative and qualitative assessments including the nature of account balances and financial statement disclosures.

Materiality determination	Comments	Amount (in 000's)
Benchmark	Based on prior period total revenues. This benchmark is consistent with the prior year.	\$1,731,453
% of Benchmark	The corresponding percentage for the prior year's audit was 2.5%	2.5%
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. The corresponding amount for the prior year's audit was \$35,600.	\$43,300
Performance materiality	Used 75% of materiality, and used primarily to determine the nature, timing and extent of audit procedures. The corresponding amount for the prior year's audit was \$26,700.	\$32,500
Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the previous year's audit was \$1,780.	\$2,165

# Highly talented team

Team member	Discussion of role
<p>Lois Ouellette, CPA, CA <b>Engagement Technical Review Partner</b> <a href="mailto:louellette@kpmg.ca">louellette@kpmg.ca</a> / 905-687-3276</p>	<ul style="list-style-type: none"> <li>Lois will bring her exceptional knowledge and insights into the challenges and emerging accounting issues relating to PSAB accounting to the team</li> </ul>
<p>Paul Ciapanna, CPA, CA <b>Audit Manager</b> <a href="mailto:ppciapanna@kpmg.ca">ppciapanna@kpmg.ca</a> / 905-523-2228</p>	<ul style="list-style-type: none"> <li>Paul will work closely with Lois on all aspects of the audit.</li> <li>He will be on site and directly oversee and manage our audit field team and work closely with your management team.</li> </ul>



# 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 the City and the access to information and people in conjunction with our audit procedures, place 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 municipal experience on our audit team – as outlined in our team summary, the senior members of our team have extensive experience in audits of municipalities. This experience ensures that we are well positioned to identify and discuss observations and insights that are important to you;
- Involvement of KPMG specialists – Our audit team is supported by specialists in information risk management. We expect these specialists to provide insights and observations resulting from their audit support processes;

- Statutory audits – we will act as the core liaison for the City and all other audits for the City. We will ensure that all statutory audits are performed efficiently by ensuring work is not duplicated and knowledge is shared between corporate team and site teams. Most importantly we will ensure you are receiving quality audit service throughout the audit.

# Value for fees

Our fees are 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:

- 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:

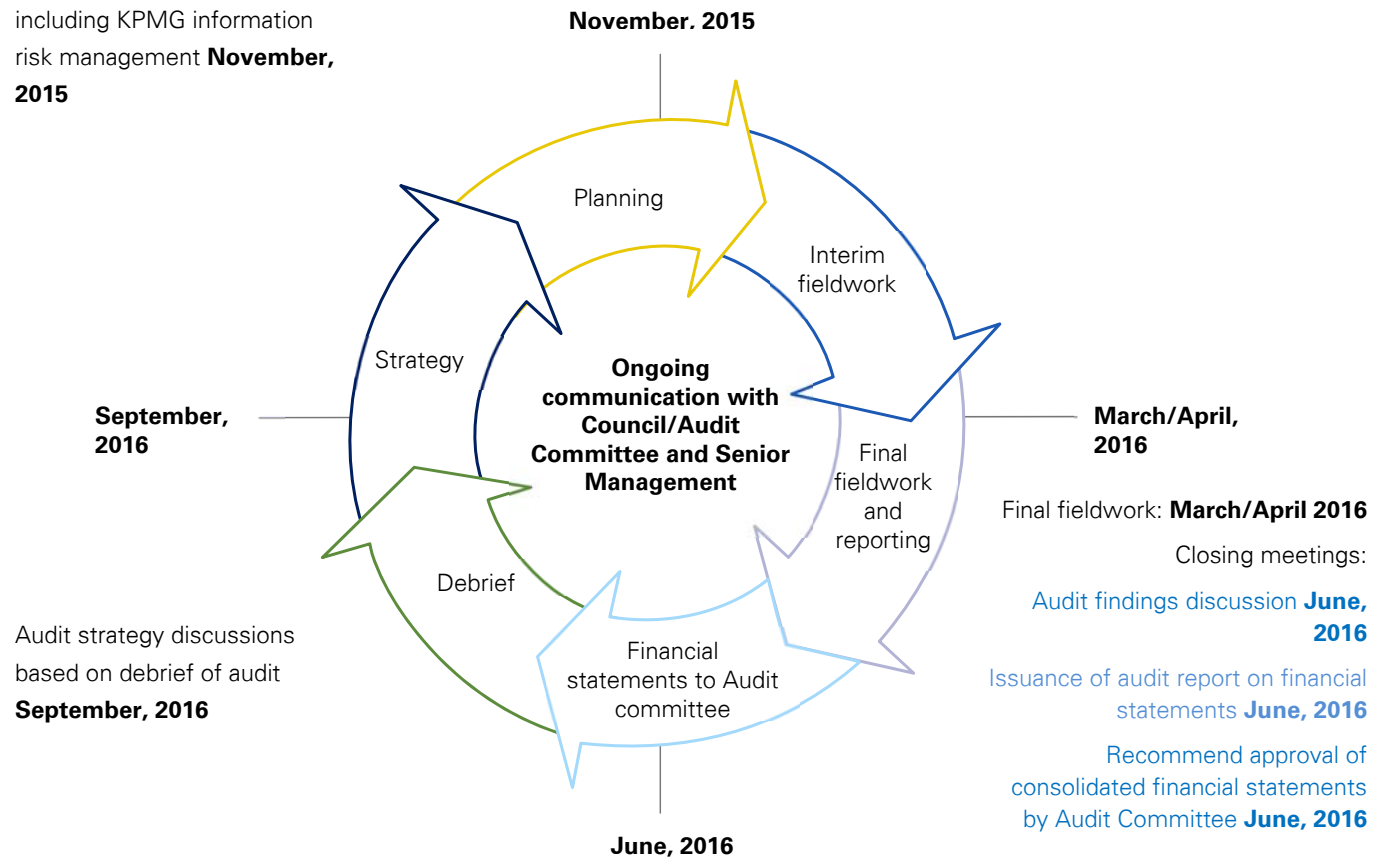
**To provide a robust audit, efficiently delivered by a high quality team focused on key issues.**

Our timeline is in line with prior year.

Planning meeting with management **November 2015**

Commence year end planning including KPMG information risk management **November, 2015**

Audit plan discussion **November, 2015**



# Appendices

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**Appendix 1: Audit Quality and Risk Management**

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**Appendix 2: KPMG's audit approach and methodology**

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**Appendix 3: Required communications**

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**Appendix 4: Current developments**

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# 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 the firm's standards of quality.



- 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 workflow (eAudit)

### Engagement Setup

- Tailor the eAudit workflow to your circumstances
- Access global knowledge specific to your industry
- Team selection and timetable

### Completion

- Tailor the eAudit workflow 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
- Required Audit Committee communications
- Debrief audit process



### Risk Assessment

- Tailor the eAudit workflow to your circumstances
- Understand your business and financial processes
- Identify significant risks
- Plan the use of KPMG specialists and others including auditor's external experts, management experts, internal auditors, service organizations auditors and component auditors
- Determine audit approach
- Evaluate design and implementation of internal controls (as required or considered necessary)

### Testing

- Tailor the eAudit workflow to your circumstances
- Perform tests of operating effectiveness of internal controls (as required or 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
- **Required inquiries** – professional standards require that during the planning of our audit we obtain your views on risk of fraud and other matters. 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 certain representations 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** – at the completion of our audit, we will provide a report to the Audit Committee

# Appendix 4: Current developments

The following is a summary of the accounting standard changes that are relevant to the Municipality.

Standard	Summary and implications	Reference
<p>PS 3260 – Liability for Remediation and Mitigation of Contaminated Sites</p>	<p>A revised standard has been issued to establish standards on accounting for liabilities relating to future remediation of contaminated sites. This standard requires a municipality to record a liability when an authoritative environmental standard exists, the contamination in question exceeds the standard and the City is directly responsible or accepts responsibility for the contamination. Voluntary compliance with a non-authoritative policy or guidelines may create a liability. This standard relates predominately to properties that are not in active use, but also relates to those which have contamination from unforeseen events such as spills. This standard is effective for fiscal periods beginning on or after April 1, 2014 (the City's December 31, 2015 year-end).</p> <p>Implications: This standard may require the City to record a liability for contaminated sites that has not been previously recorded.</p>	<p>For further information, please attend the upcoming webcast and register at: <b><a href="https://event.webcasts.com/starthere.jsp?ei=1056217&amp;j=35846712&amp;e=bchurch@kpmg.ca&amp;l=17643611_HTML&amp;u=514558180&amp;mid=10490152&amp;jb=1">https://event.webcasts.com/starthere.jsp?ei=1056217&amp;j=35846712&amp;e=bchurch@kpmg.ca&amp;l=17643611_HTML&amp;u=514558180&amp;mid=10490152&amp;jb=1</a></b></p> <p>Please also visit: <b><a href="http://www.kpmg.com/Ca/en/industry/PublicSector/Pages/liability-for-contaminated-sites-the-clock-is-ticking.aspx">http://www.kpmg.com/Ca/en/industry/PublicSector/Pages/liability-for-contaminated-sites-the-clock-is-ticking.aspx</a></b></p>
<p>PS Introduction</p>	<p>This standard provides the standards to be followed by government partnerships. Government business partnerships (with all public sector partners) are to follow the standards applicable to publicly accountable entities in Part I of the <i>CPA Canada Handbook Accounting</i>. Non-business government partnerships with only government partners can chose either PSA Standards or the standards applicable to publicly accountable entities in Part I of the <i>CPA Canada Handbook Accounting</i>. Government partnerships that have one or more private sector partners should use the standards determined by the partners. This section also requires government organizations that meet the new definition of government components to apply the PSA Standards</p> <p>This standard is effective for fiscal periods beginning on or after January 1, 2017 (the City's December 31, 2017 year end)</p>	



Standard	Summary and implications	Reference
PS 3380 – Contractual Rights	<p>This standard defines contractual rights to future assets and revenue.</p> <p>Information about a public sector entity's contractual rights should be disclosed in notes or schedules to the financial statements and should include descriptions about their nature and extent and the timing. The standard also indicates that the exercise of professional judgment would be required when determining contractual rights that would be disclosed. Factors to consider include, but are not limited to:</p> <ul style="list-style-type: none"> <li>(a) contractual rights to revenue that are abnormal in relation to the financial position or usual business operations; and</li> <li>(b) contractual rights that will govern the level of certain type of revenue for a considerable period into the future.</li> </ul> <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end).</p> <p>Implications: Additional disclosures may be required if contractual rights to assets or revenue exist</p>	
PS 2200 Related Party Disclosures	<p>This standard relates to related party disclosures and defines related parties. Related parties could be either an entity or an individual. Related parties exist when one party has the ability to control or has shared control over another party. Individuals that are key management personnel or close family members may also be related parties.</p> <p>Disclosure is only required when the transactions or events between related parties occur at a value different from what would have been recorded if they were not related and the transactions could have a material financial impact on the financial statements. Material financial impact would be based on an assessment of the terms and conditions underlying the transaction, the financial materiality of the transaction, the relevance of the information and the need for the information to enable the users to understand the financial statements and make comparisons.</p> <p>This standard also specifies the information required to be disclosed including the type of transactions, amounts classified by financial statement category, the basis of measurement, and the amounts of any outstanding items, any contractual obligations and any contingent liabilities. The standard also requires disclosure of related party transactions that have occurred where no amounts has been recognized.</p> <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end).</p> <p>Implications: Related parties will have to be identified. Additional disclosures may be required with respect to transactions with related parties.</p>	

Standard	Summary and implications	Reference
PS 3430 Restructuring Transactions	<p>This standard prescribes measurement standards and disclosure requirements when a restructuring transaction exists. A restructuring transaction in the public sector differs from an acquisition as they generally include either no or nominal payment. It also differs from a government transfer as the recipient would be required to assume the related program or operating responsibilities.</p> <p>The standard requires that assets and liabilities are to be measured at their carrying amount. It also prescribes financial statement presentation and disclosure requirements.</p> <p>This standard is effective for fiscal periods beginning on or after April 1, 2018 (the City's December 31, 2019 year end).</p> <p>Implications: Not likely to impact the City</p>	
PS 3420 Inter-entity Transactions	<p>This standard relates to the measurement of transactions between public sector entities that comprise the government's reporting entity.</p> <p>Transactions are recorded at carrying amounts with the exception of the following:</p> <ul style="list-style-type: none"> <li>● In the normal course of business – use exchange amount</li> <li>● Fair value consideration – use exchange amount</li> <li>● No or nominal amount – provider to use carrying amount; recipient choice of either carrying amount or value fair.</li> <li>● Cost allocation – use exchange amount</li> </ul> <p>This standard is effective for fiscal periods beginning on or after April 1, 2018 (the City's December 31, 2019 year end).</p> <p>Implications: The City will have to identify these transactions and determine if they have been measured at the carrying amount if required.</p>	

Standard	Summary and implications	Reference
PS 3210 - Assets	<p>This standard provides a definition of assets and further expands that definition as it relates to control.</p> <p>Assets are defined as follows:</p> <ul style="list-style-type: none"> <li>• They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.</li> <li>• The public sector entity can control the economic resource and access to the future economic benefits.</li> <li>• The transaction or event giving rise to the public sector entity's control has already occurred.</li> </ul> <p>The standard also includes some disclosure requirements related to economic resources that are not recorded as assets to provide the user with better information about the types of resources available to the public section entity.</p> <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end).</p> <p>Implications: Assets will have to be reviewed to determine if they meet this definition</p>	
PS 3320 – Contingent Assets	<p>This standard defines contingent assets.</p> <p>They have two basis characteristics:</p> <ul style="list-style-type: none"> <li>• An existing condition or situation that is unresolved at the financial statement date.</li> <li>• An expected future event that will resolve the uncertainty as to whether an asset exists.</li> </ul> <p>The standard also has specific disclosure requirements for contingent assets when the occurrence of the confirming event is likely.</p> <p>Implications: Additional disclosures may be required if contingent assets exist.</p> <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end).</p>	

Standard	Summary and implications	Reference
Financial Instruments	<p>A standard has been issued, establishing a standard on accounting for and reporting all types of financial instruments including derivatives. The effective date of this standard has recently been deterred and it is now effective for fiscal periods beginning on or after April 1, 2019 (the City's December 31, 2020 year-end).</p> <p>Implications: This standard will require the City to identify any contracts that have embedded derivatives and recognize these on the consolidated statement of financial position at fair value. Portfolio investments in equity instruments are required to be recorded at fair value. Changes in fair value will be reported in a new financial statement – statement of remeasurement gains and losses. This standard sets out a number of disclosures in the financial statements designed to give the user an understanding of the significance of financial instruments to the City. These disclosures include classes of financial instruments and qualitative and quantitative risk disclosures describing the nature and extent of risk by type. The risks to be considered include credit, currency, interest rate, liquidity, and market risk.</p>	
Revised Standard on Foreign Currency Translation	<p>A revised standard has been issued establishing standards on accounting for and reporting transactions that are denominated in a foreign currency.</p> <p>The effective date of this standard has been deferred and is effective for fiscal periods beginning on or after April 1, 2019 (the City's December 31, 2020 year-end). Earlier adoption is permitted. An entity early adopting this standard must also adopt the new financial instruments standard.</p> <p>Implications: Exchange gains and losses arising prior to settlement are recognized in a new statement of remeasurement gains and losses.</p>	

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

Topic	Summary and implications
Cyber security	<p>The threats from cyber adversaries are continuing to grow in scale and sophistication. NPOs worldwide now openly acknowledge that cyber attacks are one of the most prevalent and high impact risks they face.</p> <p><a href="#">Cyber security for Canada’s Not-for-Profit Organizations – Attack is certain – Your loss is not</a></p>
Employer compliance audits	<p>Recently, Canada Revenue Agency (“CRA”) has demonstrated a renewed focus on “Employer Compliance Audits”, which include a review of various employer-provided benefits, as well as the nature of the relationship that exists between an employer and its employees and other third party consultants.</p> <p><a href="#">Employer compliance audits – Are your benefits taxable?</a></p>
Assets safeguarding	<p>Fraud can derail the good work an NPO performs. Both the financial loss and the reputational damage that result from an incident of fraud can have lasting consequences and tarnish the goodwill created by the NPO’s past efforts.</p> <p><a href="#">Safeguarding Not-for-Profit Organizations from fraud</a></p>
Income tax issues associated with operating a business	<p>The funding landscape for organizations in the public sector has changed dramatically over the last number of years. Government or public funding agencies no longer have the ability to fully support public purpose organizations that were established legally as either Charities or NPO’s for tax purposes.</p> <p><a href="#">The income tax issues associated with operating a business within a Charity or Not-for-Profit organization</a></p>
Making the most of your charitable gifts for 2015	<p>How you structure your charitable donations can be as important as the amounts you give, both to the charity and to the donation’s after-tax cost to you.</p> <p><a href="#">Making the most of your charitable gifts for 2015</a></p>
Why is Risk Management important for NPOs?	<p>Strong governance, supported by effective enterprise risk management, are foundational to a Not-for-Profit organization’s ability to anticipate and effectively respond to complex challenges.</p> <p><a href="#">The importance of Enterprise Risk Management to a Not-for-Profit organization</a></p>

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