



AUDIT

The City of Hamilton Municipality

**Audit Findings Report
For the year ended December 31, 2015**

Prepared May 9, 2016
for June 6, 2016 meeting

kpmg.ca



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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

Purpose of this report

The purpose of this Audit Findings Report is to assist you, as a member of Council, in your review of the results of our audit of the consolidated financial statements of the City of Hamilton (the "City") as at and for the year ended December 31, 2015.

This Audit Findings Report builds on the Audit Plan we presented to Council in December 8, 2015.

Changes from the Audit Plan

There have been no significant changes regarding our audit from the Audit Planning Report previously presented to you.

Audit risks and results

We discussed with you at the start of the audit, there are no significant reporting risks that have been identified. Other areas of focus included:

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

We have no significant matters to report to the audit committee in respect of them other than what is described below.

Audit adjustments and differences

We did not identify any adjustments that were communicated to management and subsequently corrected in the financial statements.

Executive summary (continued)

Finalizing the audit

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

- Receipt of legal letter replies
- Receipt of signed management representation letters
- Completing our discussions with the Audit Committee;
- Obtaining evidence of Council's approval of the financial statements.

We will update you on significant matters, if any arising from the completion of the audit, including the completion of the above procedures. Our auditors' report will be dated upon the completion of any remaining procedures.

Control and other observations

No significant deficiencies in internal control over financial reporting came to our attention.

Independence

We confirm that we are independent with respect to the City (and its related entities), within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies in Canada. We have extensive quality control and conflict checking processes in place.

Significant Accounting Policies and Practices

New accounting standard on Liabilities for Contaminated Sites became effective for year ends beginning on or after April 1, 2014. The adoption of this standard did not have a material impact on the City's financial statements.

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Audit risks and results

Other areas of focus for our audit, as identified in our discussion with you in the Audit Plan, include the following:

Other areas of focus

Our significant findings from the audit

Revenue recognition and deferral

We performed substantive testing over the recognition of significant developer contributions and charges earned.
We ensured the charges and contributions were recognized as the eligible expenditures are incurred.

Tangible Capital Assets ("TCA")

We obtained the year-end TCA continuity schedule and tested significant additions and disposals during the year.

- We tested significant contributed assets and ensured these assets were appropriately recognized and included in TCA at fair value.
- We performed substantive testing over depreciation of TCA.
- We found no misstatements during our testing of TCA.

Post-Employment Liability

The City provides certain employee benefits which will require funding in future periods. These benefits include sick leave, benefits under the Workplace Safety Insurance Board ("WSIB") Act, life insurance, maternity leave top-up and extended health and dental benefits for early retirees. The liability of these future benefits has been determined by actuarial valuation.

We obtained a copy of the most recent actuarial valuation completed in 2014 with updated projections for 2015 and evaluated management's expert and their work for use as audit evidence.

We reviewed management's assumptions and data for reasonableness. This was compared to the assumptions used by the actuary in for consistency.

We determined that the work of management's expert and management's assumptions were reasonable and could be used as audit evidence.

Audit risks and results (Continued)

Other areas of focus for our audit, as identified in our discussion with you in the Audit Plan, include the following:

Other areas of focus

Our significant findings from the audit

Landfill Liability

The City owns and operates one open landfill sites and owns and maintains 12 closed landfill sites. The present value of the expected closure and post closure care costs of the open landfill sites and present value of expected monitoring and capital rehabilitation costs of the closed landfill sites have been reported as a liability on the Consolidated Statement of Financial Position. All closure costs for the open landfill site and post closure care costs for the closed sites were based upon management estimates, adjusted by 3% inflation. The costs were discounted back to December 31, 2015 using a discount rate of 4.5%.
We concur with management's assumptions and did not find any audit misstatements.

Investments

We confirmed all significant investments held at year end for both cost and fair market value. We performed substantive analytical testing over investment income and noted the amount of related income earned in the current year was reasonable.

Audit risks and results (Continued)

Other areas of focus for our audit, as identified in our discussion with you in the Audit Plan, include the following:

Other areas of focus

Our significant findings from the audit

Contaminated Sites

On January 1, 2015, the City adopted PS 3260, Liability for Contaminated Sites, as required. This standard was applicable for all entities reporting under Public Sector Accounting Standards for years beginning on or after April 1, 2014.

Under this standard, liabilities for remediation efforts related to contaminated sites, or parts of a site, no longer in active or productive use are required to be reported. It also requires the assessment of any unexpected events occurring on sites in productive use owned by the City that resulted in contamination.

As a result of this new standard, management

- reviewed the requirements for liability recognition
- reviewed property owned by the City and assessed whether it was in productive use
- consulted with appropriate staff members to ascertain if contamination existed
- determined the amount of liability that should be recorded.

The City's process in implementing this standard was well documented and provided excellent audit evidence for this liability.

The impact on the financial statements as a result of adoption of this standard was not material.

- KPMG provided training to management and staff on the requirements of the new standard
- Attended team discussions regarding the methodology used to assess the productive use of the site and determination of contamination
- Reviewed financial statements for disclosures and presentation of the transition to the new Standard.

Divestiture of the Central Utilities Plant (CUP)

The City transferred the CUP to HCE Energy Inc. (HCE) effective January 1, 2015 for \$2,400,000 in cash and a note receivable in the amount of \$8,100,000 from Hamilton Utilities Corporation.

KPMG examined the agreements and reviewed the accounting for the divestiture.

No audit misstatements were identified.

Audit risks and results (Continued)

Other areas of focus for our audit, as identified in our discussion with you in the Audit Plan, include the following:

Other areas of focus

Our significant findings from the audit

Operating expenditures (including payroll)

We completed various audit procedures around operating expenditures, including payroll and employee benefits expenditures. We performed a detailed comparison of operating expenditures to budget and investigated significant variances. No misstatements related to operating expenses were identified during our testing.

SAMS issue

Since the implementation of the Social Assistance Management System (SAMS) in 2014, the City as well as other municipalities across the province faced multiple challenges and difficulties. The City continues to have difficulty obtaining complete data to record social assistance expenditures and reconcile the bank account. Accounting Services staff have been reviewing the bank activities on a daily basis as a way to identify fraudulent activities.

KPMG reviewed the City's process to record and review the social assistance expenditures and performed substantive tests over the amounts recorded.

We did not identify any audit misstatements.

Financial statement presentation and disclosure

The presentation and disclosure of the financial statements are, in all material respects, in accordance with the Entity's relevant financial reporting framework. We also highlight the following:

Form, arrangement, and content of the financial statements

The financial statements are, in all material respects, in accordance with the applicable financial accounting framework. The disclosures in the notes to the financial statements are adequate.

Application of accounting pronouncements issued but not yet effective

There are no concerns at this time regarding future implementation.

Audit adjustments and differences

Audit adjustments and differences identified during the audit have been categorized as Corrected audit adjustments; or Uncorrected audit differences. These include disclosure adjustments and differences.

Corrected audit adjustments

We did not identify any adjustments that were communicated to management and subsequently corrected in the financial statements.

Uncorrected audit differences

We did not identify any differences that remain uncorrected.

Appendices

Appendix 1: Required communications

Appendix 2: Management Representation Letter

Appendix 3: Audit Quality and Risk Management

Appendix 4: Background and professional standards

Appendix 5: Data & Analytics in the Audit

Appendix 1: Required communications

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

- **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. Our draft representation letter is attached.

Appendix 2: Management Representation Letter

KPMG LLP
21 King St. W.
Suite 700
Hamilton, ON L8P 4W7

June 6, 2016

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, 2015.

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 audit engagement letter dated December 14, 2015, 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 Town Council and committees of Town 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, analysts, 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.

Yours very truly,

THE CORPORATION OF THE CITY OF HAMILTON

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

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

By: Tony Del Monaco, Manager of Accounting Service

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 accounting standards for the public sector (PSAB) *related party* is defined as:

- 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 accounting standards for the public sector (PSAB) a *related party transaction* is defined as:

- 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.

Appendix 3: 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, Limited Scope 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;
 - 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 4: Background and professional standards

Internal control over financial reporting

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.

The control deficiencies communicated to you are limited to those control deficiencies that we identified during the audit.

Documents containing or referring to the audited financial statements

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.

We are also required by our professional standards when the financial statements are translated into another language to consider whether each version, available through to the date of our auditors' report, contains the same information and carries the same meaning.

Consenting to the use of the auditors' report

When specifically engaged in the engagement letter, we will provide our consent, in writing, to the use of our auditors' report, once we have completed all of the procedures required under professional standards and no unresolved matters exist.

If there are any unresolved matters arising from the performance of the above procedures, we will inform the Audit Committee and the Council of such matters.

Appendix 5: Current developments

Current Developments, created by the KPMG Public Sector and Not-for-Profit Practice, summarizes regulatory and governance matters impacting Government Organizations. We provide this information to help not-for-profit organizations understand upcoming changes and challenges they may face in their industry. We attach this summary to every audit plan and audit findings report that we provide to our public sector clients.

Standard

Summary and implications

PS 2200 - Related Party Disclosures

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.

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.

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.

This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end).

Implications: Related parties will have to be identified. Additional disclosures may be required with respect to transactions with related parties

PS 3430 - Restructuring Transactions

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.

The standard requires that assets and liabilities are to be measured at their carrying amount. It also prescribes financial statement presentation and disclosure requirements.

This standard is effective for fiscal periods beginning on or after April 1, 2018 (the City's December 31, 2019 year end).

Implications: Not likely to impact the City

<p>PS 3420 - Inter-entity Transactions</p>	<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 except when the transaction is in the normal course of business, at fair value consideration or where there is no or nominal consideration.</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: The City will have to identify these transactions and determine if they have been measured at the carrying amount if required.</p>
<p>PS 3210 - Assets</p>	<p>This standard provides a definition of assets and further expands that definition as it relates to control.</p> <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>
<p>PS 3320 – Contingent Assets</p>	<p>This standard defines contingent assets.</p> <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>
<p>Financial Instruments</p>	<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>

<p>Revised Standard on Foreign Currency Translation</p>	<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>
<p>Employer compliance audits</p>	<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>Employer compliance audits – Are your benefits taxable?</p>
<p>Cyber Security - It's more than just Technology</p>	<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>Cyber security for Canada's Not-for-Profit Organizations – Attack is certain – Your loss is not</p>
<p>Assets safeguarding</p>	<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>Safeguarding Not-for-Profit Organizations from fraud</p>

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