The City of Hamilton

Audit Findings Report

For the year ended December 31, 2016

KPMG LLP

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kpmg.ca/audit

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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 financial statements of the City of Hamilton (the "City") as at and for the year ended December 31, 2016.

This Audit Findings Report builds on the Audit Plan we presented to the Audit Committee on December 12th, 2016.

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 that our audit is risk-focused. The key risk areas of focus included:

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

We are satisfied that our audit work has appropriately dealt with the risks.

See pages 5 – 7

Adjustments and differences

We did not identify differences that remain uncorrected.

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

This Audit Findings Report should not be used for any other purpose or by anyone other than the audit 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.

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 auditor's 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 are independent and have extensive quality control and conflict checking processes in place.

Significant accounting policies and practices

There have been no initial selections of, or changes to, significant accounting policies and practices to bring to your attention.

Audit risks and results

Inherent risk of material misstatement is the susceptibility of a balance or assertion to misstatement which could be material, individually or when aggregated with other misstatements, assuming that there are no related controls.

We highlight our significant findings in respect of significant financial reporting risks as identified in our discussion with you in the Audit Plan, as well as any additional significant risks identified.

Significant financial reporting risks	Our response and significant findings
Fraud risk from revenue recognition	• Our audit approach remained consistent with the audit plan and no new risks were identified. o No audit differences were found.
Fraud risk from management override of controls	• As the risk is not rebuttable, our audit methodology incorporated the required procedures in professional standards to address this risk. • Our audit approach remained consistent with the audit plan and no new risks were identified.

Audit risks and results (continued)

We identified other areas of focus for our audit in our discussion with you in the Audit Plan

Significant findings from the audit regarding other areas of focus are as follows:

Other areas of focus	Why	Our response and significant findings
Revenue recognition and deferral	Revenue recognition is a presumed fraud risk.	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. o No audit differences were found
Operating expenditures (including payroll)	Risk surrounding the completeness, existence and accuracy of reported expenses and accruals.	We completed various audit procedures over 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.
Tangible Capital Assets ("TCA")	Judgment is involved in determining nature of project as capital versus expense. Risk relating to the classification of expenditures between capital assets and operating expenses.	We obtained the year-end TCA continuity schedule and tested significant additions and disposals during the year. o We tested significant contributed assets and ensured these assets were appropriately recognized and included in TCA at fair value. o We performed substantive testing over depreciation of TCA. o We found no misstatements during our testing of TCA.

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	Why	Our response and significant findings
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 2016 and evaluated management's expert and their work for use as audit evidence. We obtained a copy of the most recent actuarial valuation completed in 2016 and evaluated management's expert and their work for use as audit evidence. Management decided to use a discount rate of 5.10% for the pension plans for 2016 as management believes the plan asset discount rate of 5.10% (2015 – 5.75%) is a better reflection of current market rates than the rate used in 2015. We reviewed management's assumptions for reasonableness. No audit misstatements were identified.
Landfill Liability	The City owns and operates one open landfill site and owns and maintains 12 closed landfill sites. The present value of the expected closure and post closure care costs of the open landfill site 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, 2016 using a discount rate of 4.5%. We concur with management's assumptions and did not find any audit misstatements.
Investments	All investment activities shall be in compliance with the regulations (Section 418 of the Municipal Act, 2001 and Ontario Regulation 438/97, Eligible Investments and Related Financial Agreement)	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	Why	Our response and significant findings
Contaminated Sites	Under the PS 3260 Liability for Contaminated Sites 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.	We reviewed management's process for updating the contaminated sites liability including: • Updated list of property owned by the City and assessment of productive use • enquiries regarding unexpected events occurring during the year that resulted in contamination • assessment of new liabilities that should be recorded. • assumptions used in determining the liability balance We reviewed financial statements for disclosures and presentation.

Data & Analytics in the audit

As previously communicated in our Audit Planning Report, we have utilized Data & Analytics (D&A) in order to enhance the quality and effectiveness of the audit.

We have summarized areas of the audit where D&A tools and routines were used.

Other areas of focus	D&A tools and routines	Our results
Journal Entry	• Utilized KPMG application software (IDEA) to evaluate the completeness of the journal entry population through a roll-forward of 100% of the accounts. • Utilized computer-assisted audit techniques (CAAT's) to analyse journal entries and apply certain criteria to identify potential high-risk journal entries for further testing	No issues noted

Financial statement presentation and disclosure

The presentation and disclosure of the financial statements are, in all material respects, in accordance with the Companies' relevant financial reporting framework. Misstatements, including omissions, if any, related to disclosure or presentation items are in the management representation letter included in the Appendices.

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 appropriate.
Application of accounting pronouncements issued but not yet effective	There are no concerns at this time regarding future implementation of new and revised standards. New standards with effective dates in the near future are described in Appendix 6.
Critical accounting policies or practices	Critical accounting policies and practices comprise a subset of the Companies' significant accounting policies and practices. The reason why certain significant accounting policies and practices are considered critical is that they are both: • the most important to the portrayal of the Companies' financial position and financial performance, and • require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. There are no critical accounting policies and practices.

Adjustments and differences

Adjustments and differences identified during the audit have been categorized as “Corrected adjustments” or “Uncorrected differences”. These include disclosure adjustments and differences.

Professional standards require that we request of management and the audit committee that all identified differences be corrected.

Corrected adjustments

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

Uncorrected differences

We did not identify differences that remain uncorrected.

Appendices

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:

- **Auditors' report** – the conclusion of our audit is set out in our draft auditors' report attached to the draft financial statements
- **Management representation letter** – in accordance with professional standards, copies of the management representation letter are provided to the Audit and Risk Management Committee
- **CPAB Big Four Firm Public Report (November 2016)** – Please refer to http://www.cpab-ccrc.ca/Documents/Annual%20Reports/CPAB_2016_Big_Four_Inspections_Report_EN.pdf
- **CPAB 2016 Big Four Public Report: Highlights for Audit Committees** – Please refer to http://www.cpab-ccrc.ca/Documents/Annual Reports/CPAB_2016_Big_Four_Highlights_EN.pdf

Appendix 2: Value for fees

The Value of our Audit Services

We recognize that the primary objective of our engagement is the completion of the audit of the financial statements in accordance with professional standards. We also believe that our role as external auditor of the City of Hamilton 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 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 enhanced 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 you have experienced, the senior members of our team have extensive experience in audits of companies in your industry. This experience ensures that we are well positioned to identify and discuss observations and insights that are important to you, as we have demonstrated to you by insight we shared;
- Involvement of specialists – Our audit team is supported by KPMG specialists in income and other taxes, information risk management, and others as required. We expect each of the specialists have provided insights and observations as a result of their audit support processes; and
- Income taxes – while our audit procedures were not designed to identify all matters that could be relevant to the preparation of your annual returns for income and other taxes, we have shared best practices and current tax developments with your team.

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 our Audit Quality Resources page for more information including access to our audit quality report, Audit quality: Our hands-on process.

- Other controls include:
  - Before the firm issues its audit report, the 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 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.

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.

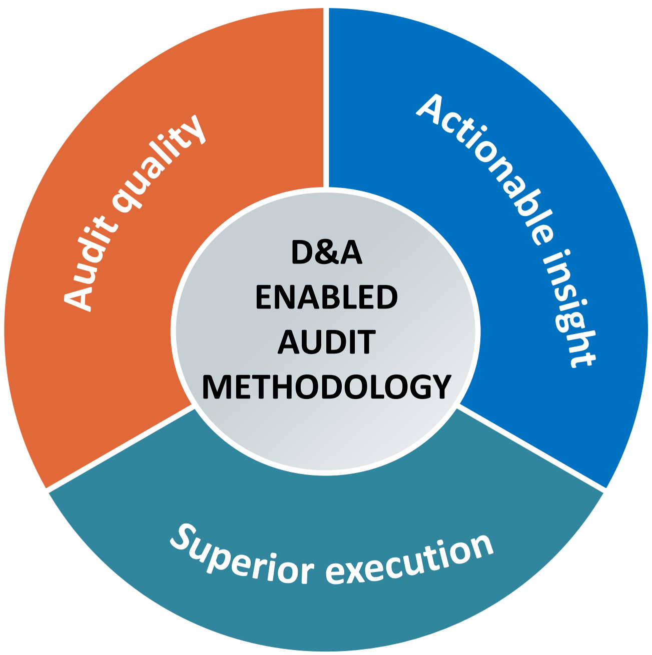
We are also required by our professional standards when the financial statements are translated into another language to consider whether each version, available through to the date of our auditors' report, contains the same information and carries the same meaning.

Appendix 5: Data & Analytics in Audit

Turning data into value

KPMG continues to make significant investments in our Data & Analytics (D&A) capabilities to help enhance audit quality and provide actionable insight to our clients by unlocking the rich information that businesses hold.

When D&A is applied to the audit, it enables us to test complete data populations and understand the business reasons behind outliers and anomalies. Advancements in D&A tools allow us to analyze data at more granular levels, focusing on higher risk areas of the audit and developing insights you can then leverage to improve compliance, potentially uncover fraud, manage risk and more.



KPMG is enhancing the audit

The combination of our proven industry experience, technical know-how and external data allows us to focus our audit on the key business risks, while providing relevant insights of value to you.

FOR THE AUDIT

AUDIT QUALITY

- Automated testing of 100% of the population
- Focuses manual audit effort on key exceptions and identified risk areas

FOR YOUR BUSINESS

ACTIONABLE INSIGHT

- Helping you see your business from a different perspective
- How effectively is your organization using your systems?

Appendix 6: Current developments

Current developments, created by KPMG Public Sector and Not-for-profit Practice, summarizes regulatory and governance matters impacting Government Organizations. We provide this information to help you understand upcoming changes and challenges they may face in the industry. We attach this summary to every audit plan and findings report (if significant changes occur).

A new accounting standard that addresses the reporting of legal obligations associated with the retirement of long-lived tangible capital assets currently in productive use is under development by PSAB. An Exposure Draft that addresses the accounting and reporting of retirement obligations associated with tangible capital assets controlled by a public sector entity was issued in March 2017. PSAB has had regular updates on this project. Implementation of this standard will require a review of the legal obligations associated with the retirement of long-lived tangible capital assets. This standard is effective for years beginning on or after April 1, 2021.

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

Standard	Summary and implications
Cyber Security Risks	With the constant changing cyber threat landscape, companies are changing their risks-protection strategies, identifying core assets and qualifying threats. Reference: KPMG: Cyber security FrontPage Video
PS 3380 – Contractual Rights	This standard is a disclosure standard which defines contractual rights to future assets and revenue and sets out the required disclosures. 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: (a) contractual rights to revenue that are abnormal in relation to the financial position or usual business operations; and (b) contractual rights that will govern the level of certain type of revenue for a considerable period into the future. Examples of a contractual right include contractual rights to receive payments under a shared cost agreement or contractual rights to receive lease payments. This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end). Implications: Additional disclosures may be required if contractual rights to assets or revenue exist.
PS 3210, Assets	This Standard provides a definition of assets and further expands that definition as it relates to control. Assets are defined as follows:

	o 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. o The public sector entity can control the economic resources and access to the future economic benefits. The transaction or event giving rise to the public sector entity's control has already occurred. o 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 sector entity. This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end). Implications: Assets such as accrued receivables will have to be reviewed to determine if they meet this definition.
PS 3320, Contingent Assets	This standard defines contingent assets. They have two basic characteristics: – An existing condition or situation that is unresolved at the financial statement date. – An expected future event that will resolve the uncertainty as to whether an asset exists. The standard also has specific disclosure requirements for contingent assets when the occurrence of the confirming event is likely. This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end). Contingent assets include grants receivable where the conditions are met but funding is conditional upon approval of an application for funding. Implications: Additional disclosures may be required if contingent assets exist.
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 3420 Inter-entity Transactions	This standard relates to the measurement of transactions between public sector entities that comprise the government's reporting entity. Transactions are recorded at carrying amounts with the exception of the following: – In the normal course of business – use exchange amount – Fair value consideration – use exchange amount – No or nominal amount – provider to use carrying amount; recipient choice of either carrying amount or value fair. – Cost allocation – use exchange amount This standard is effective for fiscal periods beginning on or after April 1, 2018 (the City's December 31, 2019 year end). Implications: The City will have to identify these transactions and determine if they have been measured at the carrying amount if required.
Financial Instruments	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 deferred and it is now effective for fiscal periods beginning on or after April 1, 2019 (the City's December 31, 2020 year-end). Implications: This standard will require the City to identify any contracts that have embedded derivatives and recognize these on the 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 re-measurement 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.

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