The Corporation of City of Hamilton

Audit Findings Report for the year ended December 31, 2018

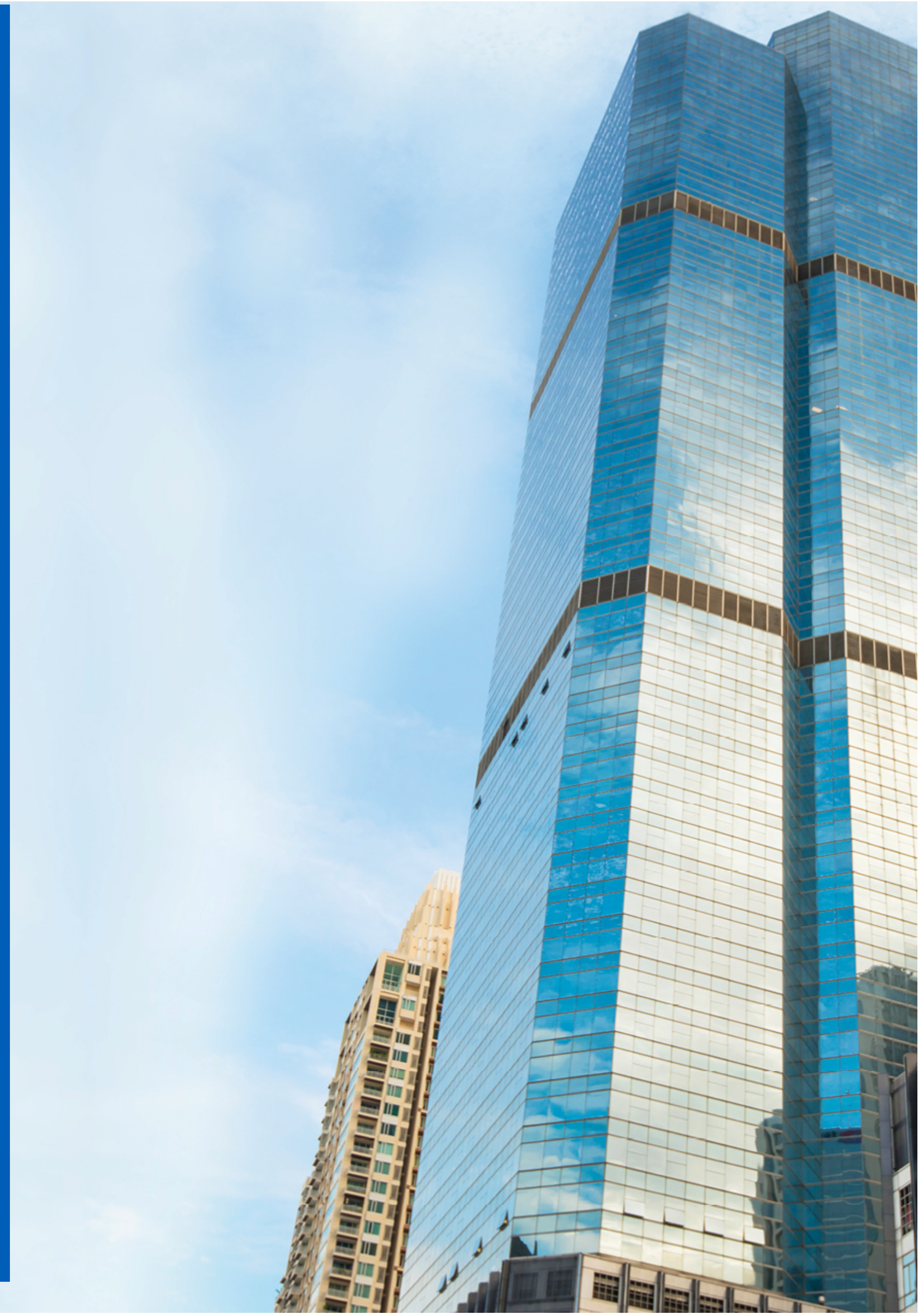
KPMG LLP

Chartered Professional Accountants,
Licensed Public Accountants

July 11, 2019

kpmg.ca/audit

KPMG



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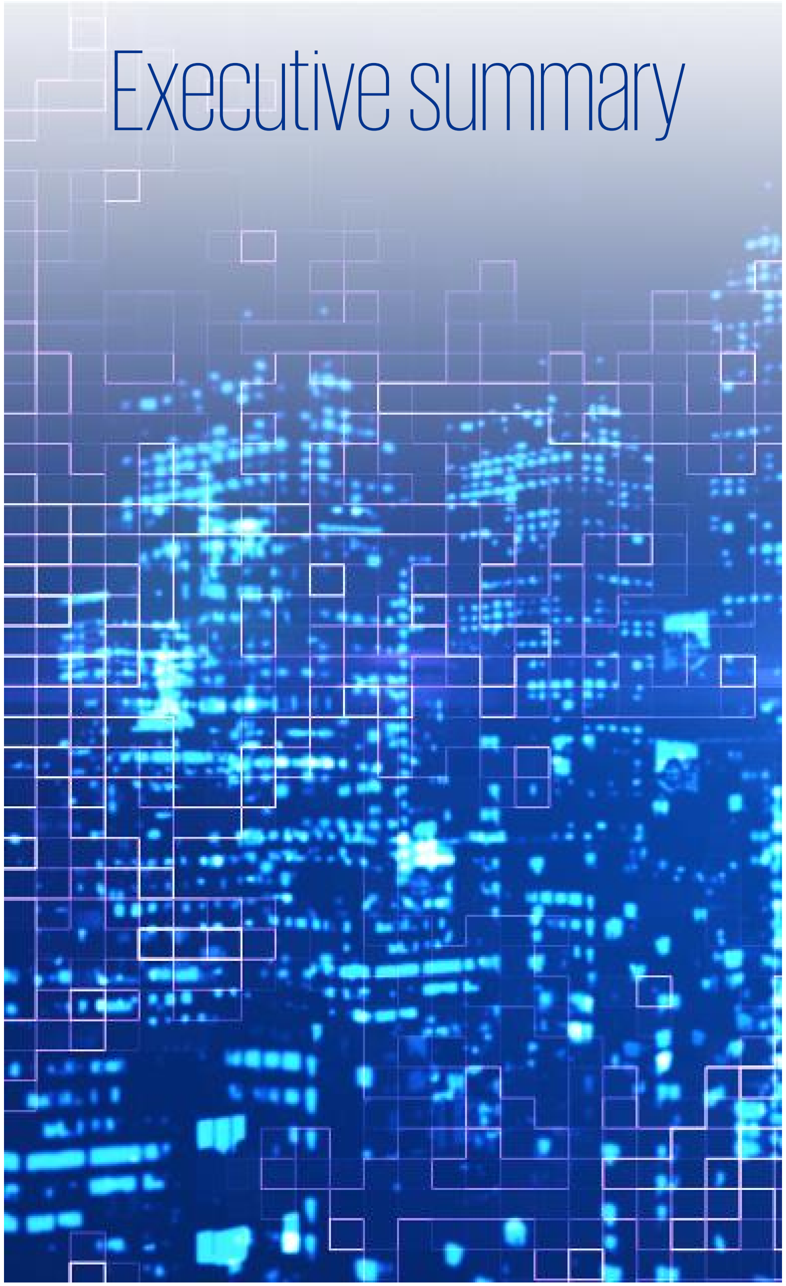
Executive summary



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 consolidated financial statements ("the financial statements") of The Corporation of the City of Hamilton ("the City") as at and for the year ended December 31, 2018.

Changes from the Audit Plan

There have been no significant changes regarding our audit from the Audit Planning Report that was presented to the A&F Committee.

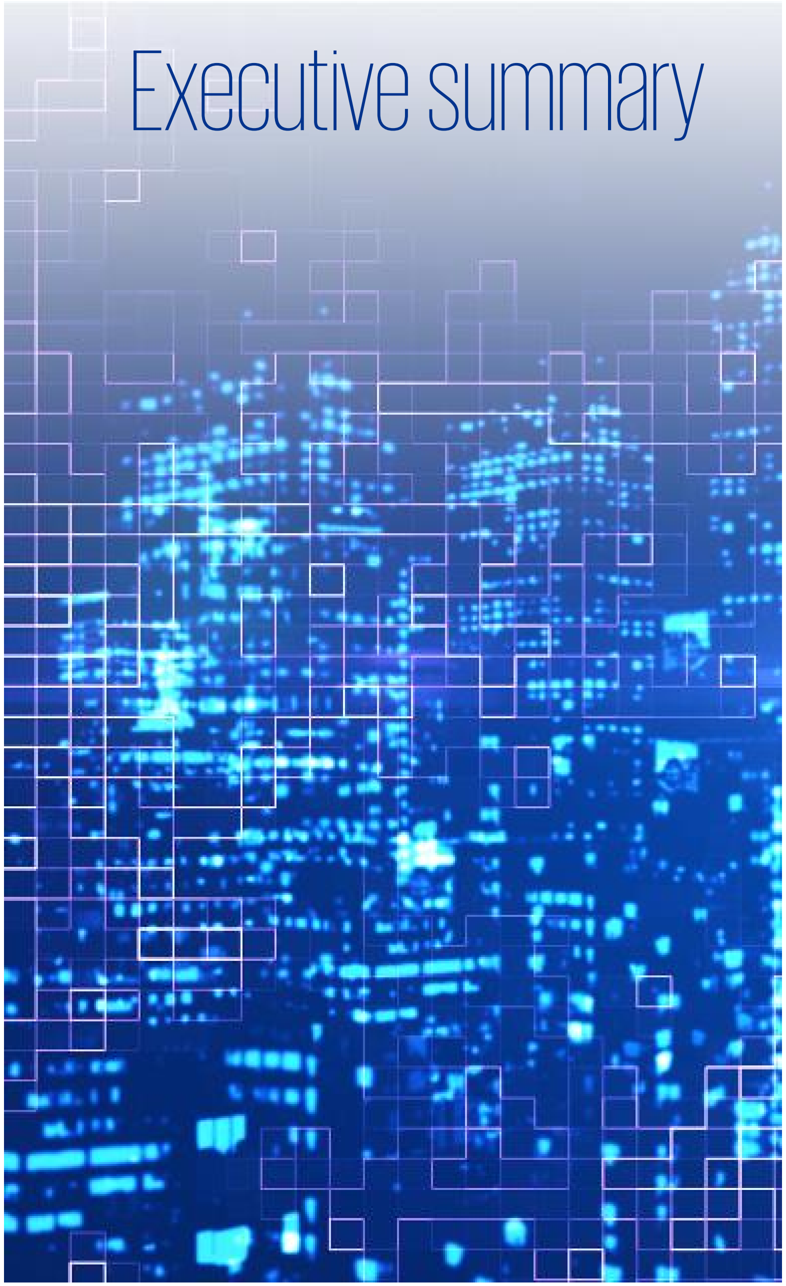
Finalizing the audit

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

- Completing our discussions with the audit committee / general committee;
- Obtaining evidence of the Council's approval of the financial statements;
- Receipt of the signed management representation letter (to be signed upon approval of the financial statements;
- Receipt of legal letter responses;

We will update the general committee, and not solely the Chair (as required by professional standards), 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.

*This Audit Findings Report should not be used for any other purpose or by anyone other than the General Committee and City Council. 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

Adjustments and differences

For the City financial statements, 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.

Accounting estimates

Overall, we are satisfied with the reasonability of accounting estimates.

The areas of estimation relate to: contingent liabilities and contaminated sites, valuation related to contributed TCA acquisitions and accruals for employee future benefits.

See pages 10-12

Significant accounting policies and practices

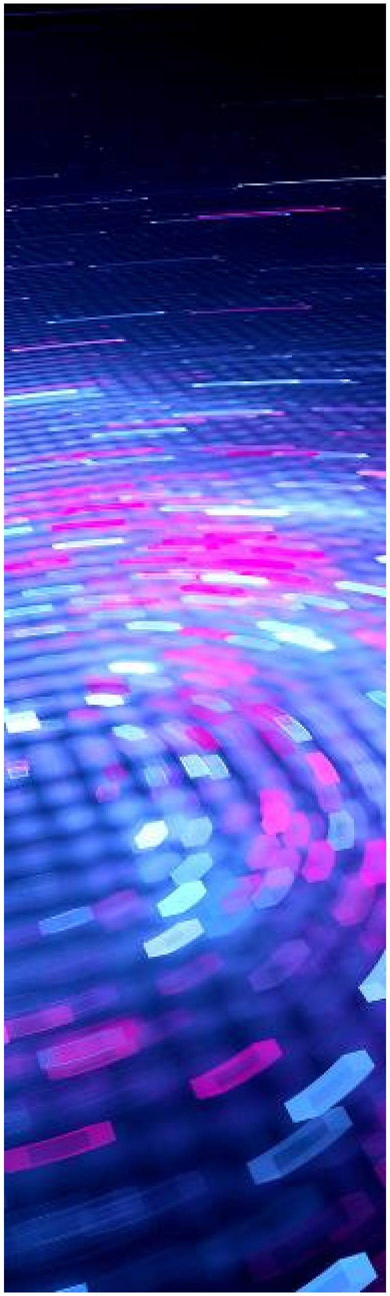
The City adopted five new public sector accounting standards in the current year: See pages 13 and 14 for considerations regarding the implementation of the new standards in the current year financial statements.

Control and other observations

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

Independence

We are independent with respect to the City of Hamilton (and its related entities), within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies in Canada and any other standards or applicable legislation or regulation. We are independent and have extensive quality control and conflict checking processes in place.



Audit risks and results

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

Significant financial reporting risk

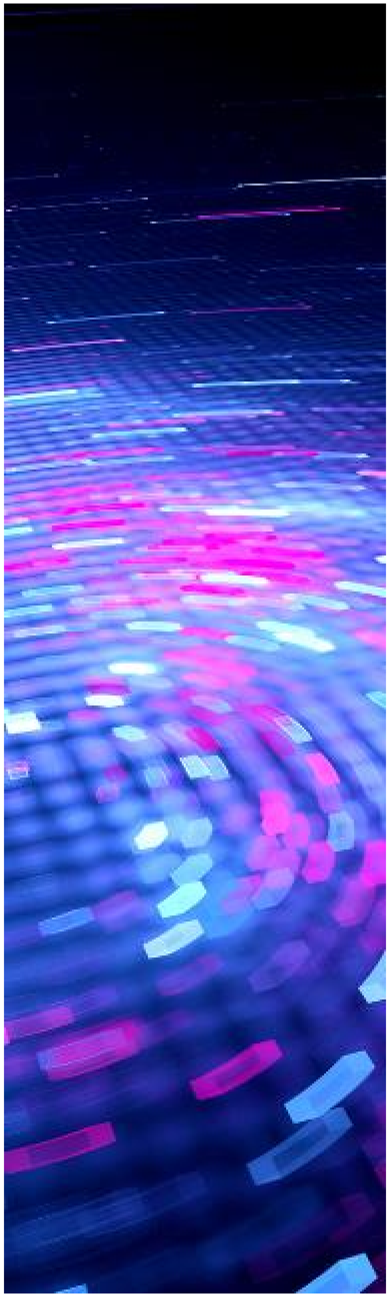
- Fraud risk from management override of control

- As this risk is not rebuttable, our audit methodology incorporated the required procedures in professional standards to address this risk.
- These procedures included the testing of journal entries and other adjustments, performing a retrospective review of estimates and evaluating the business rationale of significant unusual transactions.
- We did not identify any issues or concerns regarding management override of controls.

Significant financial reporting risk

- Fraud risk from revenue recognition

- Our audit methodology incorporated the required procedures in professional standards to address this risk.
- These procedures included testing of journal entries and other adjustments, substantively testing revenues (both recognized and amounts held as deferred at year end), and recalculating management’s determination of deferred revenue – obligatory reserve funds through auditing management’s methodology.
- We did not identify any issues related to fraud risk associated with revenue recognition.



Audit risks and results

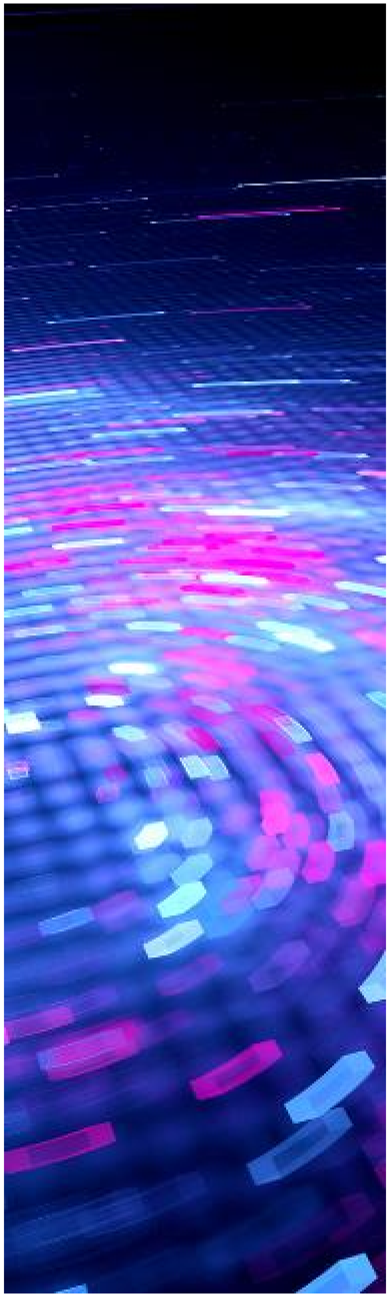
Significant findings from the audit regarding other areas of focus are as follows:

Area of focus

– Tangible capital assets (“TCA”)

Our response and significant findings

– During our substantive testing of tangible capital asset additions, we noted that the City recognized $455.2M (2017 -$369.1M) in total additions, which is comprised of $11.1M (2017 – 7.6M) of assets capitalized from work in progress (“WIP”) and $46.8M (2017 - $18.2M) relating to assets capitalized from developer contributions
– We reviewed on a sample basis the additions to tangible capital assets and noted that management has correctly capitalized the additions from work in progress to capital assets and developer contributed assets. Developer contributed assets were appropriately valued.
– In our testing, we reviewed the contributions from developers and others recognized on the statement of operations and accumulated surplus and noted that management has appropriately recognized the related revenue.
– No exceptions were noted during testing.



Audit risks and results

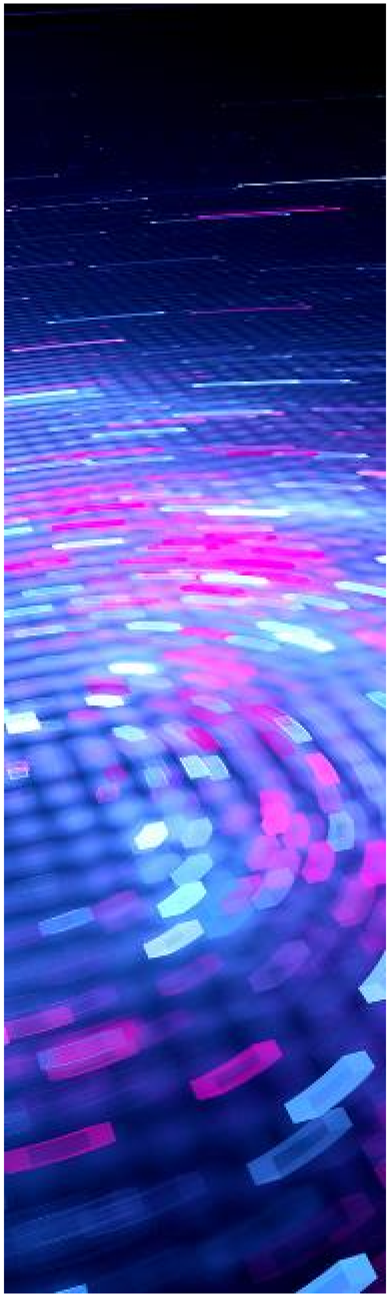
Significant findings from the audit regarding other areas of focus are as follows:

Area of focus

- Revenue recognition and deferral policies including grants

Our response and significant findings

- We performed substantive testing over the recognition of developer contributions and charges earned
- During our testing, we noted that the City recognized $27M of deferred revenue earned
- We obtained the deferred revenue continuity schedule and selected samples for testing to determine if the selected amounts had been recognized in the current year in accordance with the appropriate legislation or agreements that the revenues pertain to
- Based on our testing, we conclude that deferred revenue was recognized appropriately
- No exceptions were noted during testing



Audit risks and results

Area of focus

– Landfill Liability and liability for contaminated sites

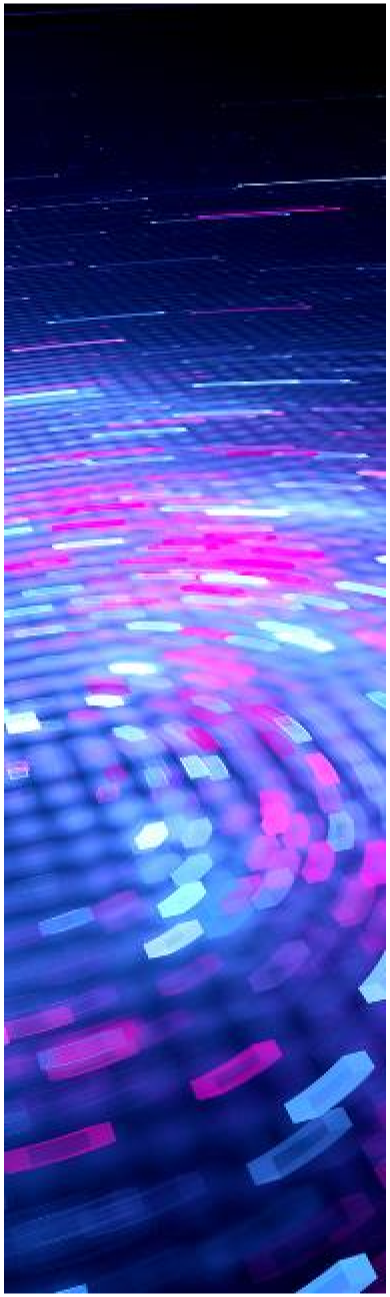
Our response and significant findings (continued)

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 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 3.5% inflation. The costs were discounted back to December 31, 2018 using a discount rate of 4.5%.
- We reviewed and assessed management assumptions and reviewed the report prepared by management’s expert.

Liability for contaminated sites

- We reviewed management’s process for identifying potential contaminated sites and reviewed management’s listing of contaminated sites and the analysis against the prescribed criteria to determine if a liability should be recorded.
- We gained an understanding and assessed the reasonability of the remediation estimates for contaminated sites deemed to be relevant to this standard and performed a recalculation of the present value of the determined liability.
- Where applicable, we obtained the reports procured from subject matter experts by management and evaluated the reasonability of the applied discount and inflation rates.
- We concur with management’s assumptions and did not find any audit misstatements.



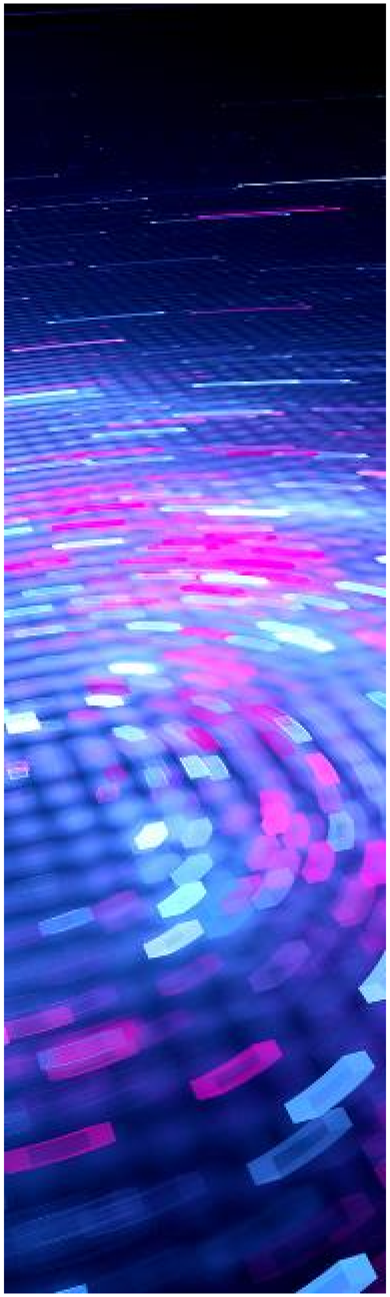
Audit risks and results

Area of focus

– Investments and related income

Our response and significant findings (continued)

- 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). There is a risk of material misstatement related to accuracy, valuation and ownership
- We obtained third party confirmations from the financial institutions holding the investments and ensure that management's records agreed in 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

Area of focus

– Operating expenditures

Our response and significant findings (continued)

— Risk surrounding the completeness, existence and accuracy of reported expenses and accruals.

— We completed various substantive audit procedures over operating expenditures, including payroll and employee benefits expenditures.

— We performed a detailed comparison of operating expenditures to budget and used the variances to determine the extent of testing to perform.

— No misstatements related to operating expenses were identified during our testing.

Accounting estimates

Certain figures in the consolidated financial statements contain elements requiring the use of judgment and assumptions that management makes about the future, and other sources of estimation uncertainty, at the end of the reporting period. These judgments and estimates have a risk of resulting in a material adjustment to carrying amounts of assets and liabilities within the next financial year.

We have summarized our assessment of the subjective areas.

Item	
Contingent Liabilities and contaminated sites	See discussion below

KPMG comment

Contingent Liabilities:

– The CPA Handbook PS 3300 Contingent Liabilities requires that the City recognize a liability when *"…it is likely that a future event will confirm that a liability has been incurred at the date of the financial statements; and the amount can be reasonably estimated."*

– At any point in time, the City is subject to a number of matters which could potentially result in the determination of a contingent liability as defined above, including, but not limited to matters such as legal claims, contract settlements etc.

– We reviewed the City's assessments of contingent liabilities and the process employed to develop and record the estimated liabilities. Where applicable, we met with the individuals responsible for the process and are satisfied that the methodology used is consistent with the approach taken in prior years and has been appropriately reviewed.

– As these items are resolved, it is possible that the final amounts recorded for these liabilities may change, however the amounts currently recorded represent management's best estimates of exposure given the information presently available.

Accounting estimates continued

KPMG comment (con’t)

Contaminated Sites:

- We reviewed management’s processes 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.
- No misstatements were identified.

Accounting estimates continued

Item	Balance
Valuation related to contributed TCA acquisitions	$ 46.8M

KPMG comment

- Contributed assets are normally tangible capital assets that have been donated or transferred to the municipality. The City received $46.8M (2017 - $18.2M) of donated and contributed assets.
- PSAB 3150 *Tangible Capital Assets* indicates that contributed assets are to be measured at fair value which may be determined by using the market value or appraised value. If the fair value cannot be determined, the asset should be recorded at a nominal value.
- KPMG obtained a listing of all contributed assets and performed substantive testing by corroborating the fair values recorded by management to third party appraisals or market research.
- No exceptions were noted during testing

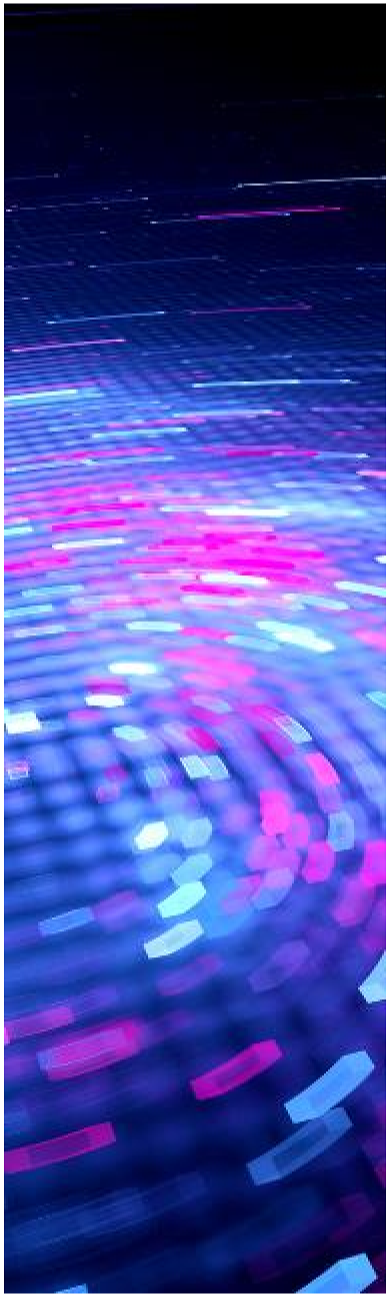
Accounting estimates continued

Item	Balance
Employee future benefits obligation	$ 373.1M

KPMG comment

Employee future benefits:

- The City provides certain employee benefits which will require funding in future periods. These benefits include long-term disability, benefits under the Workplace Safety Insurance Board (“WSIB”) Act and extended health and dental benefits for early retirees. The liability for these future benefits has been determined by actuarial valuation
- We obtained the current year’s valuation update of the obligation from management’s third party actuary and performed procedures to verify the significant assumptions and inputs
- We ensured management’s reporting of the estimate was accurate based on the expert’s valuation and that the appropriate disclosures were made within the financial statements
  a) Based on our testing, we conclude that EFB obligation was recognized appropriately
  b) We placed reliance on the actuary and evaluated their credentials
- No exceptions were noted during testing



Significant accounting policies

Adoption of accounting standards

The following new significant accounting policies and practices were selected and applied during the period as per the requirement of Public Sector Accounting Standards. These accounting policies will be applied prospectively.

Our response and significant findings

For the year ended December 31, 2018, the City is required to adopt the following new public sector accounting standards (PSAS) :

PS 2200 – Related Party Disclosures

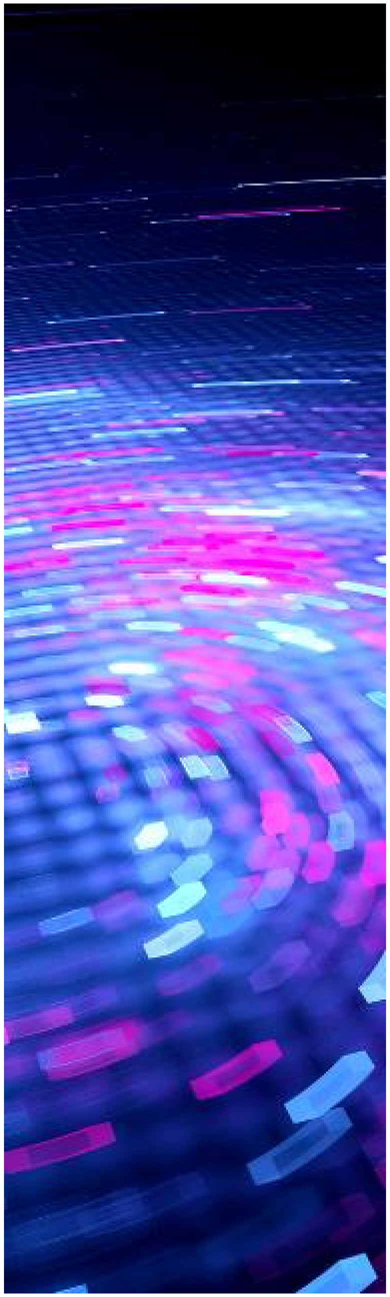
- This standard defines related parties and requires disclosure of material transactions occurring between related parties at a value that is different from that which would have been arrived at if the parties were unrelated.
- The City has internal policies over procurement and conduct that address conflicts of interest and transactions with individuals or parties at non-arms' length. We held discussions with management who informed us that there were no material related party transactions that were not transacted at fair value during the year. Our findings from our review of Council and committee meeting minutes were consistent in this regard. At the completion of the audit, we will obtain from management a signed representation letter indicating that there were no related parties or transactions not identified to us or disclosed in the financial statements.

PS 3420 – Inter-Entity Transactions

- There are no inter-entity transactions to consider as there are no commonly-controlled entities to the City.

PS 3380 – Contractual Rights

- Contractual rights, which are rights to economic resources arising from contracts or agreements that will result in both an asset and revenue in the future, must be disclosed and described. As at December 31, 2018, there were a number of contracts for funding support, shared services, and leases. The aggregate amounts for each of these types of contracts are disclosed in note 21 to the financial statements.



Our response and significant findings (con't)

– For a sample of contracts, we verified the maximum amount available to the City, ensured that amounts are to be earned in future periods, and recalculated the future portions by deducting actual revenues earned to date on the contracts.

PS 3320 – Contingent Assets

Contingent assets, which exist when an unresolved existing condition exists and an expected future event will resolve that uncertainty as to whether an asset exists, must be disclosed. Management has considered a number of circumstances, including litigation where the City is the plaintiff and situations with the potential for recoveries. Management has not identified any contingent assets, which is supported by the City Solicitor. No disclosures are required.

PS 3210 – Assets

- Items meeting the expanded definition of assets must be recorded as assets in the statement of financial position. The City has recorded all such assets. This standard does not have a significant impact on the financial statements.

Technology in the audit

As previously communicated in our Audit Planning Report, we have utilized technology to enhance the quality and effectiveness of the audit.

Areas of the audit where Technology and D&A routines were used

Tool	Our results and insights
Journal Entry Testing	We utilized our proprietary D&A tool, IDEA, to evaluate the completeness of the journal entry population through a roll-forward of all accounts, analyze journal entries and determine sub-populations for more focused and risk-based testing, and apply certain criteria to sub-populations to identify potential high-risk journal entries for further testing. We did not identify any issues in regards to the completeness of journal entries. Moreover, we are satisfied with the results of our testing of specific relevant journal entries

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 adjustments or differences be corrected. We have already made this request of management.

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.

Current developments and audit trends

Title	Details	Link
Public Sector Update - connection series	Public Sector Accounting Standards are evolving – Get a comprehensive update on the latest developments from our PSAB professionals. Learn about current changes to the standards, active projects and exposure drafts, and other items.	Contact your KPMG team representative to sign up for these webinars.
Comprehensive Accounting Advisory	A program to assist your Finance team in meeting their CPD requirements of their professional bodies. The program includes 10 hours of in-depth CPD-eligible training tailored to your Finance team and an annual licence to access KPMG Learning's extensive online course catalogue with 100+ courses.	Contact your KPMG team representative to sign up for Comprehensive Accounting Advisory.

Our discussions with you, our audit opinion and what KPMG is seeing in the marketplace—both from an audit and industry perspective—indicate the following is specific information that will be of particular interest to you. We would, of course, be happy to further discuss this information with you at your convenience.

Thought Leadership	Overview	Links
Accelerate	Accelerate is a KPMG trends report and video series that includes the perspective of subject matter leaders from across KPMG in Canada on seven key issues impacting organizations today that are disrupting the audit committee mandate.	Link to report
The Blockchain shift will be seismic	Blockchain technology is a focused disruptor of the very foundations of external and internal audit: financial recordkeeping and reporting. This Audit Point of View article offers insight on how blockchain technology is impacting business and what audit committees should be thinking about to prepare for certain risks.	Link to report
Audit Quality 2017	Learn about KPMG's ongoing commitment to continuous audit quality improvement. We are investing in new innovative technologies and building strategic alliances with leading technology companies that will have a transformative impact on the auditing process and profession. How do we seek to make an impact on society through the work that we do?	Link to report
Cyber defense in depth	High walls alone won't defend the castle Assume that you have been compromised and work on what needs to be done to address it.	Link to report

Current developments and audit trends

Public Sector Accounting Standards

The following are upcoming changes that will be effective in future periods. We have provided an overview of what these standards are and what they mean to your financial reporting so that you may evaluate any impact to your future financial statements.

Standard	Summary and implications
Asset Retirement Obligations	– A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2021 *(for the City's 2022 year end)*. – The new standard addresses the recognition, measurement, presentation and disclosure of legal obligations associated with retirement of tangible capital assets in productive use. Retirement costs would be recognized as an integral cost of owning and operating tangible capital assets. PSAB currently contains no specific guidance in this area. – The ARO standard would require the public sector entity to record a liability related to future costs of any legal obligations to be incurred upon retirement of any controlled tangible capital assets ("TCA"). The amount of the initial liability would be added to the historical cost of the asset and amortized over its useful life. – As a result of the new standard, the public sector entity would have to: • consider how the additional liability will impact net debt, as a new liability will be recognized with no corresponding increase in a financial asset; • carefully review legal agreements, senior government directives and legislation in relation to all controlled TCA to determine if any legal obligations exist with respect to asset retirements; • begin considering the potential effects on the organization as soon as possible to coordinate with resources outside the finance department to identify AROs and obtain information to estimate the value of potential AROs to avoid unexpected issues.
Revenue	– A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2022 (*for the City's 2023 year end)*. – The new standard establishes a single framework to categorize revenues to enhance the consistency of revenue recognition and its measurement. – The standard notes that in the case of revenues arising from an exchange, a public sector entity must ensure the recognition of revenue aligns with the satisfaction of related performance obligations.

	– The standard notes that unilateral revenues arise when no performance obligations are present, and recognition occurs when there is authority to record the revenue and an event has happened that gives the public sector entity the right to the revenue.
Financial Instruments and Foreign Currency Translation	– New accounting standards, PS3450 *Financial Instruments*, PS2601 *Foreign Currency Translation*, PS1201 *Financial Statement Presentation* and PS3041 *Portfolio Investments* have been approved by PSAB and are effective for years commencing on or after April 1, 2021 *(for the City's 2022 year end)*. – Equity instruments quoted in an active market and free-standing derivatives are to be carried at fair value. All other financial instruments, including bonds, can be carried at cost or fair value depending on the government's choice and this choice must be made on initial recognition of the financial instrument and is irrevocable. – Hedge accounting is not permitted. – A new statement, the Statement of Remeasurement Gains and Losses, will be included in the financial statements. Unrealized gains and losses incurred on fair value accounted financial instruments will be presented in this statement. Realized gains and losses will continue to be presented in the statement of operations. – Based on stakeholder feedback received, PSAB is considering certain scope amendments to PS 3450 *Financial Instruments*. An exposure draft with the amendments is expected to be issued in December 2018. The proposed amendments are expected to include the accounting treatment of bond repurchases, scope exclusions for certain activities by the federal government, and improvements to the transitional provisions.
Employee Future Benefit Obligations	– PSAB has initiated a review of sections PS3250 *Retirement Benefits* and PS3255 *Post-Employment Benefits, Compensated Absences and Termination Benefits*. Given the complexity of issues involved and potential implications of any changes that may arise from this review, the project will be undertaken in phases. Phase I will address specific issues related to measurement of employment benefits. Phase II will address accounting for plans with risk sharing features, multi-employer defined benefit plans and sick leave benefits. – Three Invitations to Comment were issued and have closed. The first Invitation to Comment sought guidance on whether the deferral provisions in existing public sector standards remain appropriate and justified and the appropriateness of accounting for various components of changes in the value of the accrued benefit obligation and plan assets. The second Invitation to Comment sought guidance on the present value measurement of accrued benefit obligations. A third Invitation to Comment sought guidance on non-traditional pension plans. – The ultimate objective of this project is to issue a new employment benefits section to replace existing guidance.
Public Private Partnerships ("P3")	– A taskforce was established in 2016 as a result of increasing use of public private partnerships for the delivery of services and provision of assets. – A Statement of Principles ("SOP") was issued in August 2017 which proposes new requirements for recognizing, measuring and classifying infrastructure procured through a public private partnership. An Exposure Draft of the new standard is expected to be issued in December 2018. – The SOP proposes that recognition of infrastructure by the public sector entity would occur when it controls the purpose and use of the infrastructure, when it controls access and the price, if any, charged for use, and it controls any significant interest accumulated in the infrastructure when the P3 ends.

	– The SOP proposes the public sector entity recognize a liability when it needs to pay cash or non-cash consideration to the private sector partner for the infrastructure. – The infrastructure would be valued at cost, with a liability of the same amount if one exists. Cost would be measured by discounting the expected cash flows by a discount rate that reflects the time value of money and risks specific to the project.
Concepts Underlying Financial Performance	– PSAB is in the process of reviewing the conceptual framework that provides the core concepts and objectives underlying Canadian public sector accounting standards. – A Statement of Concepts (“SOC”) and Statement of Principles (“SOP”) were issued for comment in May 2018 and has closed. – The SOC proposes a revised, ten chapter conceptual framework intended to replace PS 1000 *Financial Statement Concepts* and PS 1100 *Financial Statement Objectives*. The revised conceptual framework would be defined and elaborate on the characteristics of public sector entities and their financial reporting objectives. Additional information would be provided about financial statement objectives, qualitative characteristics and elements. General recognition and measurement criteria, and presentation concepts would be introduced. – The SOP includes principles intended to replace PS 1201 *Financial Statement Presentation*. The SOP proposes: • Removal of the net debt indicator, except for on the statement of net debt where it would be calculated exclusive of financial assets and liabilities that are externally restricted and/or not available to settle the liabilities or financial assets. • Changes to common terminology used in the financial statements, including re-naming accumulated surplus (deficit) to net assets (liabilities). • Restructuring the statement of financial position to present non-financial assets before liabilities. • Removal of the statement of remeasurement gains (losses) with the information instead included on a new statement called the statement of changes in net assets (liabilities). This new statement would present the changes in each component of net assets (liabilities). • A new provision whereby an entity can use an amended budget in certain circumstances. – Inclusion of disclosures related to risks and uncertainties that could affect the entity’s financial position.
International Strategy	– PSAB is in the process of reviewing its current approach towards International Public Sector Accounting Standards. This project may result in changes to the role PSAB plays in setting standards in Canada. – A consultation paper was released for comment in May 2018 and has closed. The consultation paper described the decision-making criteria PSAB expects to consider in evaluating the international strategy that best serves the public sector. It also introduced four proposed international strategies that PSAB considers to be viable.


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 Committee. Management has provided you with a copy of the representation letter for the audit of the financial statements.

Appendix 2: 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 summarizes the six key elements of our quality control system.

Visit our Audit Quality Resources page for more information including access to our most recent Audit Quality Report.

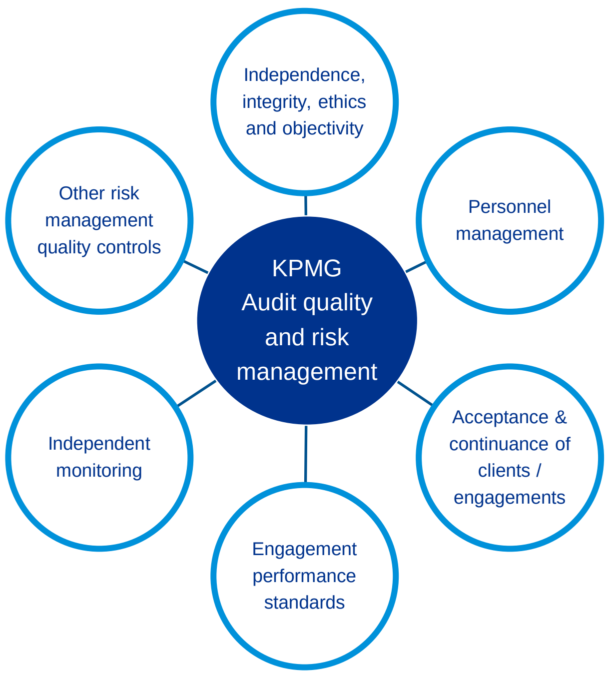
Other controls include:

- 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

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 3: 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 or material weaknesses and therefore, there can be no assurance that all significant deficiencies or material weaknesses 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.

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