



The City of Hamilton

**Audit Planning Report for the
year ended December 31, 2019**

Prepared for the January 16, 2020 Audit,
Finance and Administration committee
meeting

kpmg.ca/audit



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Executive summary



KPMG



Audit and business risks

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

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

See pages 5-9



Audit materiality

Materiality has been determined based on prior period total revenues. We have determined group materiality to be \$51,200,000.

We have reviewed the scope of work across segments and business across the group. Materiality will be set at lower thresholds where necessary to meet requirements of various funding agencies.



Executive summary



Independence & Quality Control

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



Current developments and Audit Trends

Please refer to page 14 for relevant accounting and/or auditing changes relevant to the City and relevant audit trends..

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Audit risks



Professional Requirements

Fraud risk from revenue recognition.

Why is it significant?

This is a presumed fraud risk under Canadian Auditing Standards.



Our audit approach

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

- Government grants
- Development charges

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

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

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

Our audit approach will consists of performing substantive procedures to address the relevant assertions associated with the significant risk.



Audit risks



Professional Requirements

Fraud risk from management override of controls

Why is it significant?

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



Our audit approach

As the risk is not rebuttable, our audit methodology incorporates the required procedures in professional standards to address this risk. These procedures include testing of journal entries and other adjustments, performing a retrospective review of estimates and evaluating the business rationale of significant unusual transactions.

Data and analytics tools will be used to perform work in this area.



Audit risks



Other areas of focus

Government Grants

Tangible Capital Assets

Why are we focusing here?

Risk of material misstatement related to the completeness and accuracy of grant revenue

Risk of material misstatement related to the classification, completeness, and accuracy of tangible capital assets



Our audit approach

We will perform a substantive test of timing of revenue recognition

We will perform the following procedures:

- Evaluate the design and implementation of controls over disbursements
- Test the operating effectiveness of the controls
- Substantive test to confirm classification as an asset versus expense



Audit risks



Other areas of focus

Employee Future Benefits

Landfill Liability

Why are we focusing here?

Risk of material misstatement related to the completeness and accuracy of the liability and related expenses

Risk of material misstatement related to the completeness and accuracy of the liability and related expenses



Our audit approach

We will perform the following procedures:

- Substantive test over the liability balance
- Assess the assumptions of the actuary in order to rely on their work

- We will perform a substantive test over the completeness and accuracy of the liability
- Assess the assumptions used in developing the estimated liability



Audit risks



Other areas of focus

Investment and related income

Operating expenditures including payroll

Why are we focusing here?

Risk of material misstatement related to the existence and valuation of investments and accuracy of related income

Risk of material misstatement related to the completeness, existence, and accuracy of expenditures



Our audit approach

We will perform the following procedures:

- Confirm investment and income balances with investment managers
- Assess the valuation of investments

We will perform the following procedures:

- Evaluate the design and implementation of controls over disbursements
- Test the operating effectiveness of the controls
- Substantively test a sample to confirm appropriate classification and treatment of expenses



Materiality

Materiality Benchmark

Total Revenue

\$2,050,067,000

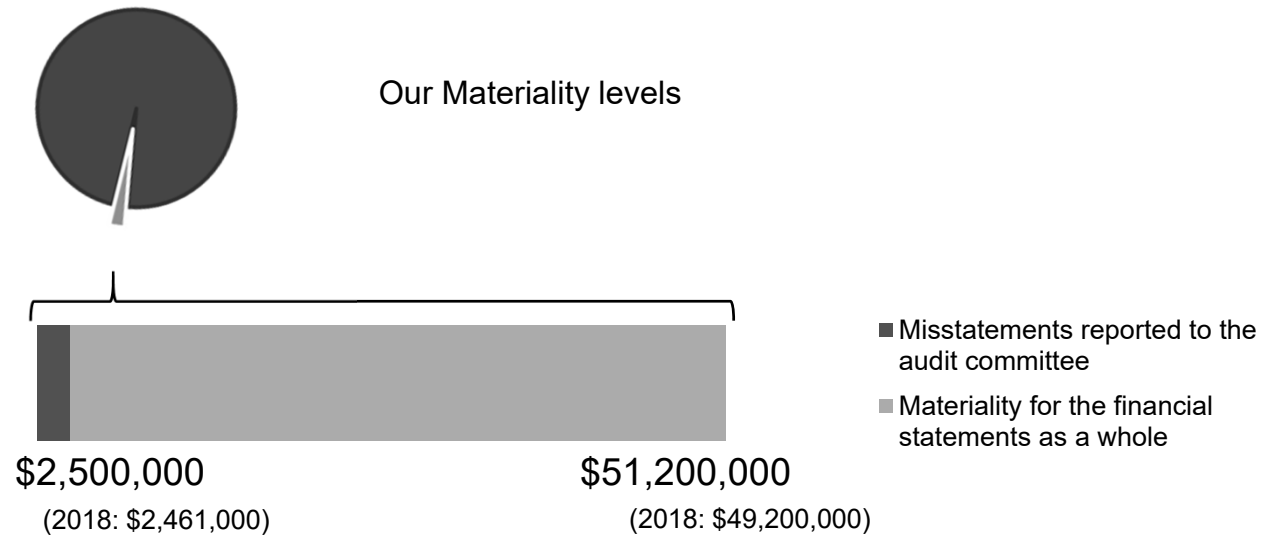
(2018: \$1,969,536,000)

Materiality

\$51,200,000

2.5% of total revenue

(2018: \$49,200,000, 2.5% of total revenue)



Materiality represents the level at which we think misstatements will reasonably influence users of the financial statements. It considers both quantitative and qualitative factors.

To respond to aggregation risk, we design our procedures to detect misstatements at a lower level of materiality.

We will report to the Audit Committee:



Corrected audit misstatements



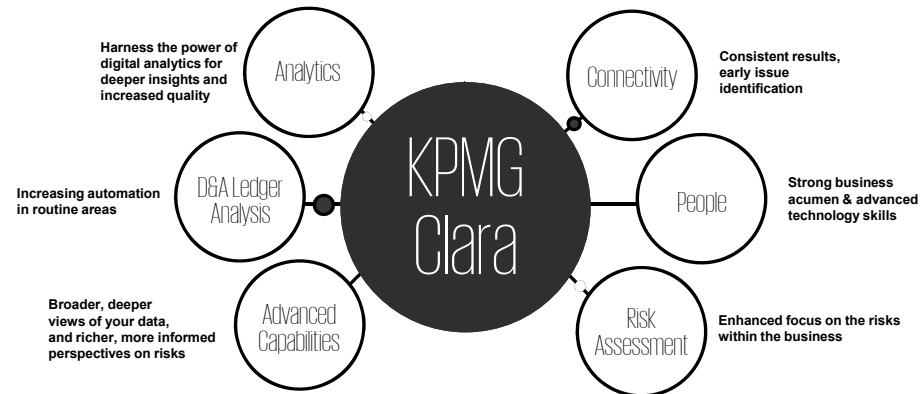
Uncorrected audit misstatements



The audit of today, tomorrow & the future

As part of KPMG's technology leadership, our audit practice has developed technologies and alliances to continuously enhance our capabilities and deliver an exceptional audit experience.

Technology empowers us with the ability to perform deep analysis over your financial information, focusing our effort and interactions on the areas of greatest risk and minimizing disruption to your business.




Technology we use today

Tool	Benefit to audit
KPMG Clara Collaboration	KCCC is our secure audit platform and a one-stop shop through which we plan, execute and manage the audit, providing you with real-time access to the process at every step, including exchange of information and access to the real-time reporting you need in one central location.
Journal Entry Analysis	Our journal entry tool assists in the performance of detailed journal entry testing based on engagement-specific risk identification and circumstances. Our tool provides auto-generated journal entry population statistics and focusses our audit effort on journal entries that are riskier in nature.
Data & Analytics Routines	We will utilize data & analytics to substantively test the entire population of depreciation expense. In addition, we will substantively test development charges using data & analytics tools to identify outliers and investigate further.



The audit of today, tomorrow & the future

 Technology under development	
Tools	Benefit to audit
Dynamic Risk Assessment	Dynamic Risk Assessment (DRA) gives us a more sophisticated, forward-looking and multi-dimensional approach to assessing audit risk. Using network theory, DRA considers not just the traditional, two-dimensional view of severity and likelihood but also how interconnected the risks are, how fast they may emerge and how systemic they are. It will provide a holistic enterprise-wide assessment of your risks, ensuring we have identified the relevant risk exposures that need to be incorporated into our audit approach.
Optical Contract Reader & Analysis Tool	Our Optical Contract Reader & Analysis Tool provides us with capabilities to improve the effectiveness and efficiency of the contract review process. This works by automating the ingestion of contracts and related source documents and extracting and summarizing key terms for the audit engagement team's consideration, in turn providing increased coverage of the population and resulting in greater audit quality. The tool can also be used to read unstructured source documents in PDF format, extracting certain data such as invoice date, invoice number, account number, order number and total amount. This data is then compiled and compared to structured data from the general ledger. Time savings generated from this intelligent automation solution will allow our team to focus their efforts on areas of greater risk.
Robotic Process Automation (RPA)	This application of cognitive computing technology allows our team to configure computer software—or a “robot”—to capture and interpret existing applications for processing a transaction, manipulating data, triggering responses, and communicating with other digital systems.



Key deliverables and milestones



November - January

Planning year-end 2019 audit and
delivering the Audit Planning
Report

Year-end fieldwork

March-April



June

2019 Audit Report



Current developments and audit trends

Please visit KPMG's [Audit Committee Institute \(ACI\) / Current Developments](#) page for current developments in IFRS, Canadian securities matters, and Canadian auditing other professional standards. The following is a summary of the current developments that are relevant to the City:

Standard	Summary and implications
– PS 3450 Financial Instruments	<p>A standard has been issued, establishing a standard on accounting for and reporting all types of financial instruments including derivatives. The effective date of this standard has recently been deterred and it is now effective for fiscal periods beginning on or after April 1, 2021 (the City's December 31, 2022 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 that are quoted in an active market 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.</p>
– PS 3280 Asset Retirement Obligations	<p>New standard released in April 2018 which provides guidance on recognition, measurement, presentation and disclosure of obligations associated with the retirement of tangible capital assets. Applies to TCA in or no longer in productive use.</p> <ul style="list-style-type: none"> - If the asset is in use, the carrying value of the TCA is increased by the asset retirement cost, which is then expensed in a rational and systematic manner. - If the asset is not in use, asset retirement costs are expensed. Standard includes the removal of asbestos. <p>Liability is recognized when there is a legal obligation to incur retirement costs.</p> <p>This new Section PS 3280 is effective for fiscal years beginning on or after April 1, 2021 (the City's December 31, 2022 year end) with early adoption permitted.</p>

Appendices



[Appendix 1: Audit quality and risk management](#)



[Appendix 2: KPMG's audit approach and methodology](#)



[Appendix 3: Lean in Audit™](#)



[Appendix 4: Required Communications](#)



Appendix 1: Audit quality and risk management



KPMG maintains a system of quality control designed to reflect our drive and determination to deliver independent, unbiased advice and opinions, and also meet the requirements of Canadian professional standards. Quality control is fundamental to our business and is the responsibility of every partner and employee. The following diagram summarises the six key elements of our quality control systems. Visit 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, 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.

We do not offer services that would impair our independence.



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.

The processes we employ to help retain and develop people include:

- Assignment based on skills and experience;
- Rotation of partners;
- Performance evaluation;
- Development and training; and
- Appropriate supervision and coaching.

We have policies and procedures for deciding whether to accept or continue a client relationship or to perform a specific engagement for that client.

Existing audit relationships are reviewed annually and evaluated to identify instances where we should discontinue our professional association with the client.



Appendix 2: KPMG's audit approach and methodology

This year we will expand our use of technology in our audit through our new smart audit platform, KPMG Clara.

Collaboration in the audit

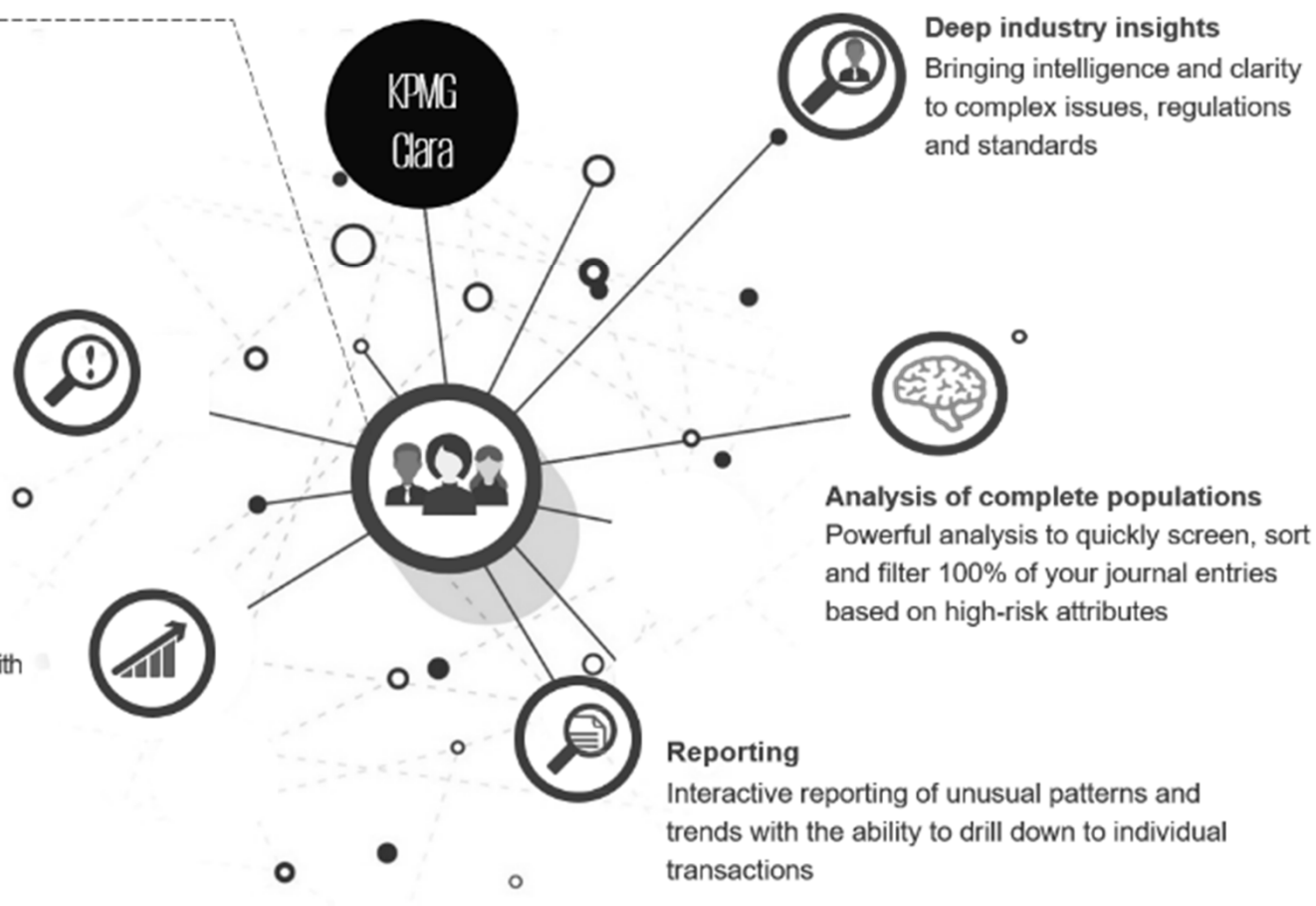
A dedicated KPMG Audit home page gives you real-time access to information, insights and alerts from your engagement team

Issue identification

Continuous updates on audit progress, risks and findings before issues become events

Data-driven risk assessment

Automated identification of transactions with unexpected or unusual account combinations — helping focus on higher risk transactions and outliers





Appendix 3: Lean in Audit™



An innovative approach leading to enhanced value and quality

Our innovative audit approach, Lean in Audit, further improves audit value and productivity to help deliver real insight to you. Lean in Audit is process oriented, directly engaging organizational stakeholders and employing hands-on tools, such as walkthroughs and flowcharts of actual financial processes.

By embedding Lean techniques into our core audit delivery process, our teams are able to enhance their understanding of the business processes and control environment within your organization – allowing us to provide actionable quality and productivity improvement observations.

Any insights gathered through the course of the audit will be available to both engagement teams and management. For example, we may identify control gaps and potential process improvement areas, while management has the opportunity to apply such insights to streamline processes, inform business decisions, improve compliance, lower costs, increase productivity, strengthen customer service and satisfaction and drive overall performance.



How it works

Lean in Audit employs three key Lean techniques:



1. Lean training

Provide basic Lean training and equip our teams with a new Lean mindset to improve quality, value and productivity.



2. Interactive workshops

Perform interactive workshops to conduct walkthroughs of selected financial processes providing end-to-end transparency and understanding of process and control quality and effectiveness.



3. Insight reporting

Quick and pragmatic insight report including immediate quick win actions and prioritized opportunities to realize benefit.



Appendix 4: 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:



Engagement letter

The objectives of the audit, our responsibilities in carrying out our audit, management's responsibilities, as well as our fees are set out in the engagement letter and any subsequent amendment letters as provided by management.



Audit planning report

This report.



Required inquiries

Professional standards require that during the planning of our audit we obtain your views on risk of fraud and other matters. We make similar inquiries of management as part of our planning process; responses to these will assist us in planning our overall audit strategy and audit approach accordingly.



Management representation letter

We will obtain from management certain representations at the completion of the annual audit. In accordance with professional standards, copies of the representation letter will be provided to the Finance and Administration Committee.



Audit findings report

At the completion of our audit, we will provide our audit findings to the Finance and Administration Committee.



Annual independence letter

At the completion of our audit, we will provide our independence letter to the Finance and Administration Committee.



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