

The City of Hamilton

Audit Planning Report
for the year ended December 31, 2020

KPMG LLP

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presentation to the Audit Committee
on January 14, 2021



Table of contents

EXECUTIVE SUMMARY	2
COVID-19: EMBEDDING RESILIENCE & READINESS	3
AUDIT RISKS	5
MATERIALITY	10
AUDIT QUALITY AND TRANSPARENCY	11
KEY DELIVERABLES AND MILESTONES	12
APPENDICES	13

Executive summary

COVID-19

On March 11, 2020, the coronavirus (COVID-19) was declared a global pandemic by the World Health Organization. In Canada, the federal and provincial governments have enacted emergency measures to combat the spread of the virus.

See pages 3 and 4 for additional discussion.

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,
- Adoption of CAS 540 - *Estimates*

Audit materiality

Materiality has been determined based on prior period total revenues. We have determined group materiality to be \$49,900,000.

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

Independence and 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 Audit Committee approved protocols.

Current developments and audit trends

Please refer to page 19 for relevant accounting and/or auditing changes relevant to the city and relevant audit trends

This Audit Planning Report should not be used for any other purpose or by anyone other than the Finance and Administration 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 Planning 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.

COVID-19: Embedding Resilience & Readiness

Potential financial reporting implications

Refer to our [COVID-19 Financial Reporting](#) site:

- Events or conditions that cast significant doubt regarding going concern
- Impairment of non-financial assets (e.g., PPE)
- Impairment of financial assets including investments
- Fair value measurements
- Employee benefits and employer obligations
- Provisions, contingencies and onerous contracts
- Impact on funding received from federal and provincial governments
- Impact on programs and operations managed by the City
- Impact on capital projects managed by the City
- Subsequent events

Potential implications on internal control over financial reporting

- Reconsideration of financial reporting risks, including fraud risks, given possible new pressures on management or new opportunities to commit fraud given changes in internal controls over Financial Reporting (ICFR) or to bias estimates
- Consideration of the appropriateness of segregation of duties because of a potential reduction in the number of employees
- Consideration of changes in the individuals performing the control (e.g. re-directing the performance to head-office or realignment efforts).
- New or enhanced detective controls to respond to new financial reporting risks or elimination of on-site preventative controls
- Reconsideration of internal control impacts related to broader IT access given work from home arrangements

Potential financial reporting implications related to disclosures

- Events and conditions that cast significant doubt regarding going concern (including "close calls")
- Significant management judgments and sources of estimation uncertainty that have significant risk
- Liquidity risks

Other potential considerations

- Reporting significant changes in ICFR
- Possible enhanced disclosure requirements (e.g. liquidity, critical accounting estimates)
- Cyber security (e.g., wire transfers schemes)
- Possible delay in approval or filing of consolidated financial statements

COVID-19: Embedding Resilience & Readiness (continued)

Similarly, COVID-19 is a major consideration in the development of our audit plan for your 2020 consolidated financial statements.

Potential audit implications

Planning and risk assessment

- Understanding the expected impact on the relevant metrics for determining materiality (including the benchmark) and the implication of that in identifying the risks of material misstatement, responding to such risks and evaluating uncorrected misstatements
- Understanding the potential financial reporting impacts, the changes in the City of Hamilton's environment, and changes in the entity's system of internal controls, and their impact on our:
 - identified and assessed risks of material misstatement
 - audit strategy, including the involvement of others and the nature, timing and extent of tests of controls and substantive procedures

Executing

- Remote auditing if required
 - Increased use of other collaboration tools (Skype, Teams, etc.) and the need for written management acknowledge for their use
 - Potential increased use of electronic evidence (and understanding the entity's processes to provide such evidence to us)
 - Timing of procedures may need to change
 - Tests of controls and related walkthroughs may need to be deferred (to allow the entity to put new or revised controls in operation and to be able to re-perform such controls)
 - Understanding the City's potential financial reporting impacts, the changes in the City's environment, and changes in the City's system of internal control, and their impact on our:
 - design of the analytical procedures
 - need to perform additional procedures or early audit work
-

Audit risks

Relevant factors affecting our risk assessment

Complexity



Estimate



Related party transaction



Significant financial reporting risk	Why is it significant?
<p>Fraud risk from revenue recognition</p>	<p>This is a presumed fraud risk under Canadian Auditing Standards.</p> <p>Audit standards require us to assume there are generally pressures/incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition. This can be penetrated through revenue cut-off or manual journal entries and other adjustments related to revenue recognition.</p>
<p>Fraud risk from management override of controls</p>	<p>This is a presumed fraud risk.</p> <p>We have not identified any specific additional risks of management override relating to this audit.</p>

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 consist of performing substantive procedures to address the relevant assertions associated with the significant risk.

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 (continued)

Other areas of Focus	Why are we focusing here
Government Grants	Risk of material misstatement related to the completeness and accuracy of grant revenue
Tangible Capital Assets	Risk of material misstatement related to the classification, completeness, and accuracy of tangible capital assets

Our audit approach

We will perform a substantive test over 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 over additions to confirm classification as an asset versus expense
- Review amortization policy and perform recalculations
- Review construction in progress to ensure amounts are properly transferred to correct capital asset classes and amortization expense commences on a timely basis.
- Review of financial statement note disclosure in accordance with PSAS.
- We will agree fair value estimates of contributed tangible capital assets to supporting third party documentation or estimated by the City; we will perform procedures to address the new CAS 540, Auditing Accounting Estimates and Related Disclosure requirements related to valuation estimates.
- We will also perform required procedures to assess the potential risks with respect to impairment of assets as a result of the ongoing COVID-19 pandemic. Based on the nature of City's operations, it is not expected that this will be a significant risk during the audit.

Audit risks (continued)

Other areas of Focus	Why are we focusing here
Employee Future Benefits (EFB)	Risk of material misstatement related to the completeness and accuracy of the liability and related expenses
Landfill Liability & contaminated sites	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:

- Reliance on actuaries (management specialist) engaged by the City; update our understanding of the activities over the quality of information used, the assumptions made, the qualifications, competence and objectivity of the preparer of the estimate, and the historical accuracy of the estimates.
- Assess method, data and, assumptions used by actuary and management in calculation of the EFB liability for reasonableness.
- We will perform audit procedures to address the new CAS 540, Auditing Accounting Estimates and related disclosure requirements related to the estimates involved. Communicate with actuaries and test HR data provided to the actuaries, if applicable.
- Review financial statement disclosures in accordance with PSAS.

We will Perform the following procedures:

- Update our understanding on the controls and practices in place at the City surrounding recognition, measurement and completeness of contaminated sites and review and testing of management's key assumptions and estimates.
- Make inquiries of key stakeholders to validate the completeness assertion of contaminated sites
- Substantive test over the completeness and accuracy of the landfill liability
- Reliance on the specialist engaged by the City to estimate the landfill liability
- Assess the method, data and assumptions used by the specialist in developing the estimated landfill liability
- We will perform audit procedures to address the new CAS 540, Auditing Accounting Estimates and related disclosure requirements related to the estimates involved.
- Review financial statement disclosures in accordance with PSAS.

Audit risks (continued)

Other areas of Focus	Why are we focusing here
Investment and related income	Risk of material misstatement related to the existence and valuation of investments and accuracy of related income
Operating expenditures including payroll	Risk of material misstatement related to the completeness, existence, and accuracy of expenditures

Our audit approach

COVID-19 Implications:

- To assess if there is a loss in value of the portfolio investment and whether such a decline is other than temporary. Perform audit procedures to assess whether a write-down is necessary.

We will perform the following procedures:

- Confirm investment and income balances with investment managers
- Review of financial statement note disclosure in accordance with Public Sector Accounting Standards (PSAS).

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
- Search for unrecorded liabilities.
- Examine significant accrued liabilities for existence, accuracy and completeness

Audit risks (continued)

Other areas of Focus	Why are we focusing here
<p>CAS 540, Auditing Accounting Estimates and Related Disclosures</p> <p>Effective for audits of Entities with year-ends on or after December 15, 2020</p>	<p>This revised auditing standard is required to set a globally consistent approach for the audit profession. As estimates become more complex, the revised standard will assist auditors in critically assessing estimates and their elements and design sufficient and appropriate procedures to address those elements. Refer to the embedded Link for CPA Canada's Audit Client Briefing notes for this new standard. LINK</p>

Our audit approach

Expected impact on the audit:

- more emphasis on the need for exercising professional skepticism
- more granular risk assessment to address each of the components in an estimate (method, data, assumptions)
- more granular audit response designed to specifically address each of the components in an estimate (method, data, assumptions)
- more focus on how we respond to levels of estimation uncertainty
- more emphasis on auditing disclosures related to accounting estimates
- more detailed written representations required from management

We anticipate there being incremental work associated with the adoption of this standard for the upcoming year-end audit both on the parts of our engagement team and on the part of management to ensure we appropriately consider and implement this requirement.

We are currently developing our proposed approach with respect to estimates and will be in discussions with your management team on the level of work required and expected involvement.

We have determined that this standard will impact the work performed over the following estimates:

- Development charges
- Landfill liability
- Contaminated sites
- Developer contributed assets
- Pending litigations
- Assessment appeals
- Employee future benefits and Other Post Employment Benefits.

This is not an exhaustive list but has been determined based on our preliminary risk assessment procedures.

Materiality

Materiality is used to identify risks of material misstatements, develop an appropriate audit response to such risks, and evaluate 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.

Materiality determination	Comments	Amount
Materiality	Determined to plan and perform the audit and to evaluate the effects of identified misstatements on the audit and of any uncorrected misstatements on the financial statements. The corresponding amount for the prior year's audit was \$51,200,000.	\$49,900,000
Benchmark	Based on total revenue from 2019-20 City of Hamilton Financial Statements. For the fiscal 2019-2020 audit the corresponding figure used in audit was \$2,050,067,000 (2018-19 revenue figure)	\$1,997,089,000
% of Benchmark	The corresponding percentage for the prior year's audit was 2.5%	2.5%
Performance materiality	Used 75% of materiality, and used primarily to determine the nature, timing and extent of audit procedures. The corresponding amount for the prior year's audit was \$38,400,000	37,400,000
Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the previous year's audit was \$2,500,000	\$2,400,000

We will report to the Audit Committee:



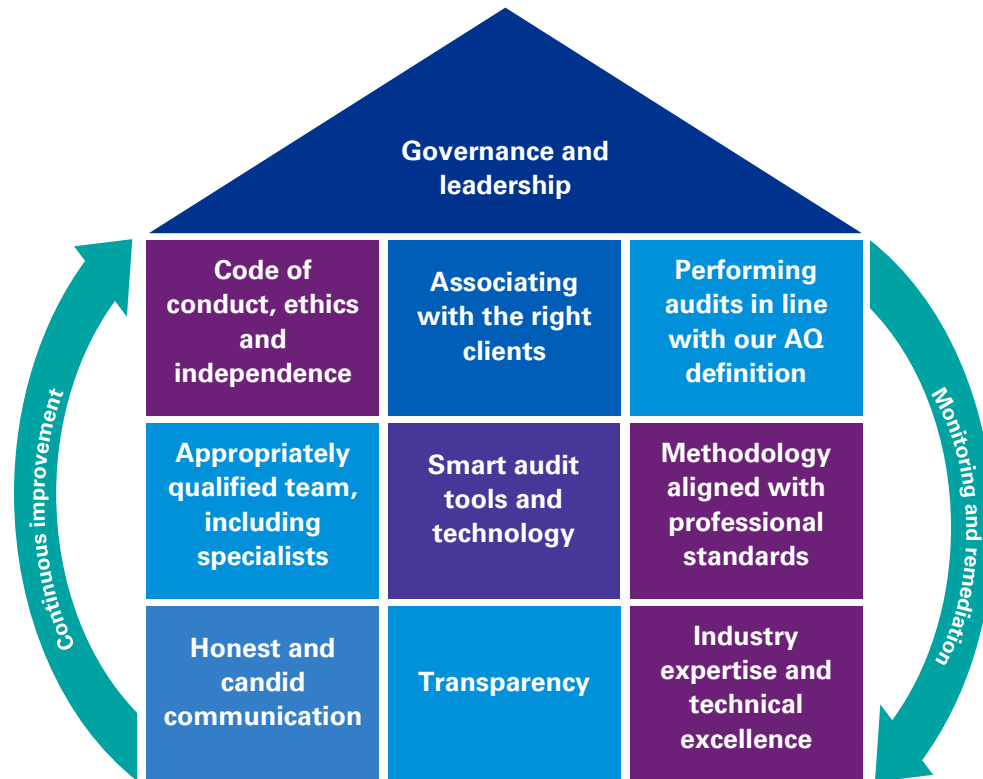
Corrected audit misstatements



Uncorrected audit misstatements

Audit quality and transparency

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 key elements of our quality control system.



Audit Quality Framework

What do we mean by audit quality?

Audit Quality (AQ) is at the core of everything we do at KPMG.

We believe that it is not just about reaching the right opinion, but how we reach that opinion.

We define 'audit quality' as being the outcome when audits are:

- Executed consistently, in line with the requirements and intent of applicable professional standards within a strong system of quality controls, and
- All of our related activities are undertaken in an environment of the utmost level of **objectivity, independence, ethics, and integrity**.

Our AQ Framework summarises how we deliver AQ. Visit our [Audit Quality Resources page](#) for more information including access to our [Audit Quality and Transparency report](#).

Key deliverables and milestones



Appendices

Content

Appendix 1: Required communications

Appendix 2: Use of technology in the audit

Appendix 3: KPMG's audit approach and methodology

Appendix 4: Lean in Audit™

Appendix 5: Audit and Assurance Insights

Appendix 6: Preparing for PSAB Standard Changes



Appendix 1: Required communications

Reports to the Audit Committee

At the completion of the audit, we will provide our findings report to the Audit Committee.

Representations of management

We will obtain from management certain representations at the completion of the audit.

Matters pertaining to independence

At the completion of our audit, we will provide re-confirm our independence with the Audit Committee.

Internal control deficiencies

Other control deficiencies, identified during the audit, that do not rise to the level of a significant deficiency will be communicated to management.

Required inquiries

Professional standards require that during the planning of our audit we obtain your views on the identification and assessment of risks of material misstatement, whether due to fraud or error, your oversight over such risk assessment, identification of suspected, alleged or actual fraudulent behaviour, and any significant unusual transactions during the period.

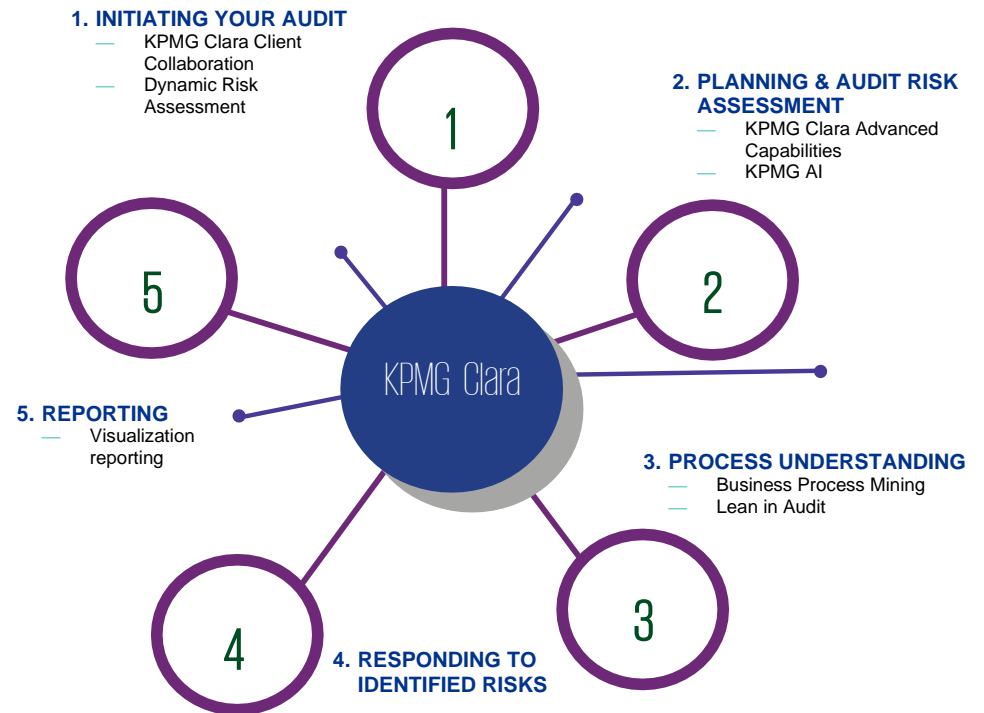
Appendix 2: Use of technology in the audit

Clara is KPMG's integrated, smart global audit platform that allows our teams globally to work simultaneously on audit documentation while sharing real time information. Clara also leverages advanced technology in the execution of various audit procedures, for overall risk assessment and for performing substantive audit procedures over 100% of selected transactions through the use of robotic process automation (KPMG "Bots"). KPMG's use of technology provides for:

1. a **higher quality audit** – looking at 100% of selected data
2. a **more efficient audit** as we are focussed on the transactions that are considered higher risk and
3. an audit that provides **insights into your business** through the use of technology in your audit with our extensive industry knowledge.

We are also actively piloting Artificial Intelligence ("AI") tools which will be used in future audits.

Our five-phased audit approach



Appendix 3: KPMG's audit approach and methodology

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.



Deep industry insights

Bringing intelligence and clarity to complex issues, regulations and standards.

Analysis of complete populations

Powerful analysis to quickly screen, sort and filter 100% of your journal entries based on high-risk attributes.

Reporting

Interactive reporting of unusual patterns and trends with the ability to drill down to individual transactions.

Appendix 4: 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 5: Audit and Assurance Insights

Our latest thinking on the issues that matter most to Audit Committees, Boards and Management.

Featured insight	Summary	Reference
Audit & Assurance Insights	Curated thought leadership, research and insights from subject matter experts across KPMG in Canada	<u>Learn more</u>
The business implications of coronavirus (COVID 19)	Resources to help you understand your exposure to COVID-19, and more importantly, position your business to be resilient in the face of this and the next global threat.	<u>Learn more</u>
	Financial reporting and audit considerations: The impact of COVID-19 on financial reporting and audit processes.	<u>Learn more</u>
Accelerate 2019/20	Perspective on the key issues driving the Audit Committee agenda	<u>Learn more</u>
Momentum	A quarterly Canadian newsletter which provides a snapshot of KPMG's latest thought leadership, audit and assurance insights and information on upcoming and past audit events – keeping management and board members abreast on current issues and emerging challenges within audit.	<u>Sign-up now</u>

Appendix 6: 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. Public Sector Minute Link

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 (“ARO”)	<ul style="list-style-type: none"> – A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2022 – 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: <ul style="list-style-type: none"> • 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.

Financial Instruments	<ul style="list-style-type: none"> – accounting standards, PS3450 <i>Financial Instruments</i>, PS2601 <i>Foreign Currency Translation</i>, PS1201 <i>Financial Statement Presentation</i> and PS3041 <i>Portfolio Investments</i> have been approved by PSAB and are effective for years commencing on or after April 1, 2022 – 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 Re-measurement 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 <i>Financial Instruments</i>. An exposure draft with the amendments is expected to be issued in 2020. 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
Revenue	<ul style="list-style-type: none"> – A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2023. – 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.
Employee Future Benefit Obligations	<ul style="list-style-type: none"> – PSAB has initiated a review of sections PS3250 <i>Retirement Benefits</i> and PS3255 <i>Post-Employment Benefits, Compensated Absences and Termination Benefits</i>. 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")	<ul style="list-style-type: none"> – 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.

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- 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.

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.
 - Two consultation papers were released for comment in May 2018 and March 2019 both of which have 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. A final decision was expected at the March 2020 meeting. As of the date of this report, nothing has been released from PSAB.
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