The City of Hamilton

Audit Planning Report
for the year ended December 31, 2021

KPMG LLP

Prepared on December 6, 2021 for presentation to the Finance and Administration Committee on January 13, 2022.

KPMG

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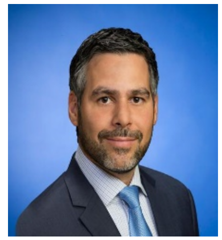

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Our refreshed Values

What we believe

Integrity
We do what is right.

Excellence
We never stop learning and improving.

Courage
We think and act boldly.

Together
We respect each other and draw strength from our differences.

For Better
We do what matters.

Executive summary

Audit Quality

See page 3 for how we deliver audit quality and how you can measure our audit quality.

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,
- Legal and compliance matters

Audit materiality

Materiality has been established by considering various metrics that are relevant to the users of the financial statements, including total revenues and total expenses. Materiality has been determined based on prior period total revenues. We have determined group materiality to be $50,300,000 (PY $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 pages 10 and Appendix 5 for relevant accounting and/or auditing changes relevant to the City and relevant audit trends

Transparency report

Audit Quality: How do we deliver audit quality?

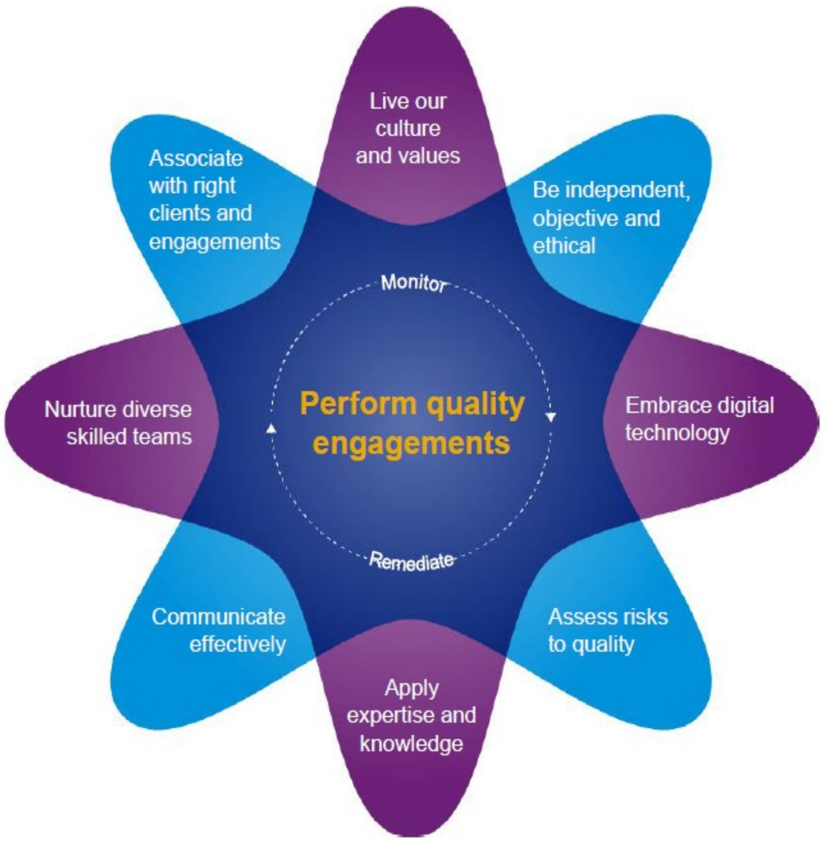
Quality essentially means doing the right thing and remains our highest priority. Our Global Quality Framework outlines how we deliver quality and how every partner and staff member contribute to its delivery.

'Perform quality engagements' sits at the core along with our commitment to continually monitor and remediate to fulfil on our quality drivers.

Our **quality value drivers** are the cornerstones to our approach underpinned by the **supporting drivers** and give clear direction to encourage the right behaviours in delivering audit quality.

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.**



Doing the right thing. Always.

Audit risks

Relevant factors affecting our risk assessment

Complexity | Estimate | Related party transaction

Significant financial reporting risk	Why is it significant?
Fraud risk from revenue recognition	This is a presumed fraud risk under Canadian Auditing Standards. 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.
Fraud risk from management override of controls	This is a presumed fraud risk. We have not identified any specific additional risks of management override relating to this audit.

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.

Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities.

We took the following steps to address this risk as required under professional standards:

- Evaluated the design and implementation of controls surrounding journal entries and other adjustments;
- Determined criteria to identify high-risk journal entries and other adjustments;

Tested high-risk journal entries and other adjustments made at the end of the reporting period

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

Our audit approach

We will perform the following procedures:

- Test the recognition of amounts subject to external restrictions to ensure they are recognized appropriately
- Confirm all significant government transfers and other similar inflows received from third parties
- On a sample basis, we will validate that the expenses incurred in the period are in compliance with restrictions imposed by third parties through an inspection of signed agreements and related invoices
- Auditing any new or continuing COVID-19 funding agreements.

We will perform the following procedures:

- Confirm investment and income balances with investment managers
- We will test management’s assessment of impairment and consider if any potential impairment of the investments exists.
- Review of financial statement note disclosure in accordance with Public Sector Accounting Standards (PSAS).

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 auditing standard introduced in the previous year, 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 auditing standard introduced in the previous year, 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
Tangible Capital Assets	Risk of material misstatement related to the classification, completeness, and accuracy of tangible capital assets
Operating expenditures including payroll	Risk of material misstatement related to the completeness, existence, and accuracy of expenditures

Our audit approach

We will perform the following procedures:

- Test the operating effectiveness of the controls to ensure appropriate communication is taking place between managers and finance with respect to when a tangible capital asset is available for use
- 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.
- Ensure 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 auditing standard introduced in the previous year 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.

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
Legal and compliance matters	Risk of material misstatement related to the completeness, accuracy and financial statement presentation of ongoing legal and compliance matters

Our audit approach

In 2018, the City informed the public that one of its combined sewer overflow tanks was discharging sewage into the Chedoke Creek. The City has been working with the Ministry of the Environment, Conservation and Parks (MECP) to respond to Orders and plan for remediation efforts in the Creek. The MECP's Orders could result in a material obligation by the City for remediation.

In 2019, the City received information regarding a 2013 friction report related to the Red Hill Valley Parkway. As a result of this report a Superior Court judge was appointed to investigate the matters relating to the disclosure of the friction report. The inquiry could result in a material legal settlement to be incurred by the City for damages.

We will perform the following procedures:

- Inquire with in-house legal counsel and management on the status of the hearings and discussions through the audit period,
- Obtain external legal confirmations evaluating likelihood and dollar value associated with any claims
- Assess the accounting implications of any decision made prior to year end and/or subsequent to year end through to the date of our auditor's report
- Ensure financial statements disclosures are in accordance with PSAS

The extent of audit effort and procedures required will be dependent on the status of these matters

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 $49,900,000.	$50,300,000
Benchmark	Based on total revenue from 2020-21 City of Hamilton Financial Statements. For the fiscal 2020-2021 audit the corresponding figure used in audit was $1,997,089,000 (2019-2020 revenue figure)	$2,015,702,000
% 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 $37,400,000	37,725,000
Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the previous year's audit was $2,400,000	$2,515,000

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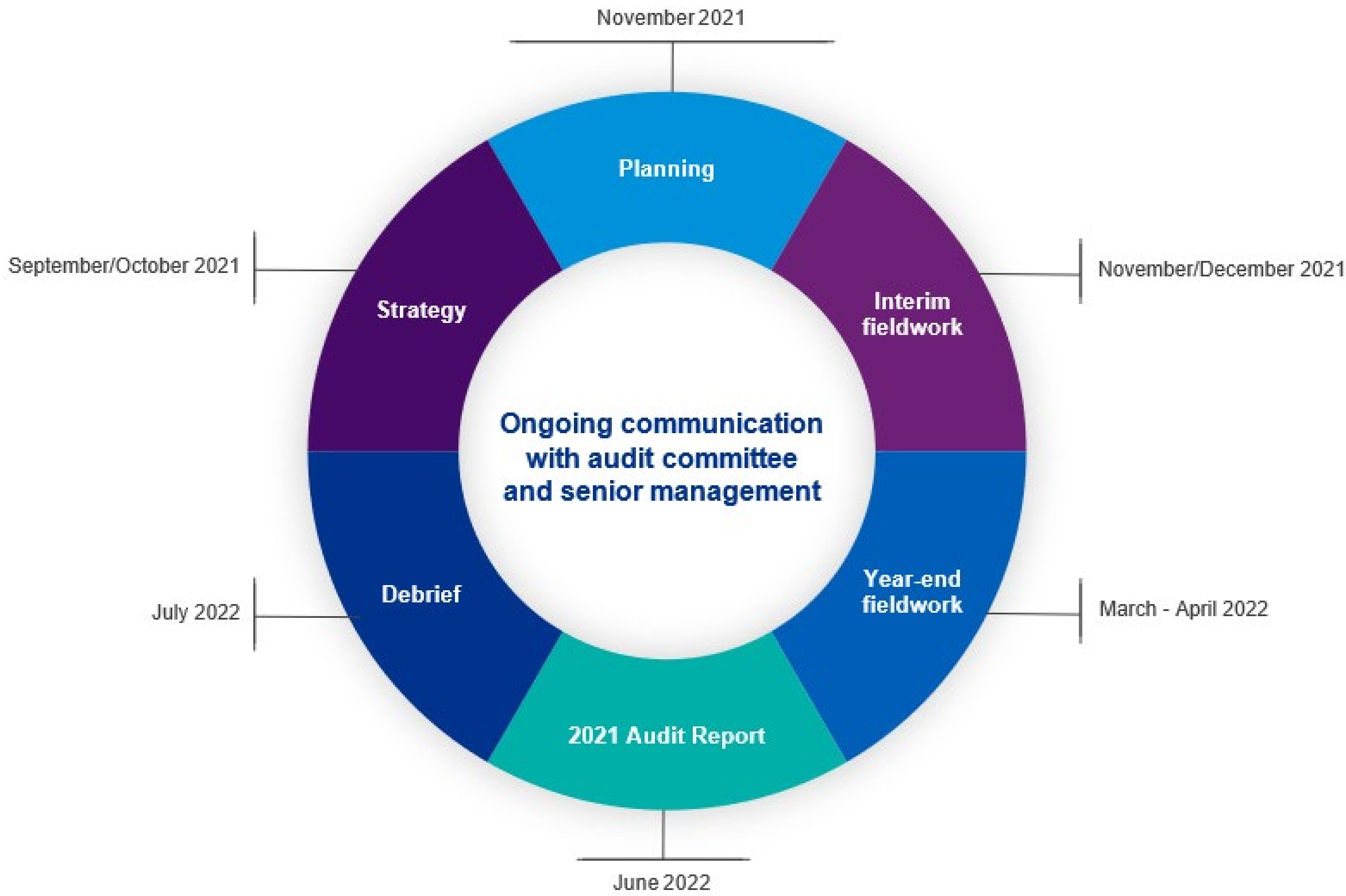
We will report to the Audit Committee:

- Corrected audit misstatements
- Uncorrected audit misstatements

Key deliverables and milestones



Current developments

Accounting standards issued but not yet effective are disclosed in the consolidated financial statements and highlighted in Appendix 5. In 2022, the City will continue to assess the impact and prepare for the adoption of these standards. While the timing of standard adoption can vary, certain standards must be adopted concurrently.

The Public Sector Accounting Board asset retirement obligation section will have a significant impact on the public sector. Municipal Councils have a vital role to play in setting the tone for a successful implementation and financial reporting success.

Standard	Summary and implications	Reference
PS3280, Asset Retirement Obligations Effective April 1, 2022 (December 31, 2023 for the City)	— Establishes guidance on the accounting and reporting of legal obligations associated with the retirement of tangible capital assets that are both in use and no longer in productive use.	In our discussions with management, we understand that an ARO stakeholder contact list has been developed and training material on the new standard is being provided. Management is developing a project plan and a complete inventory of all active and inactive assets or sites, including leased properties and non-recorded assets or sites, to identify potential retirement obligations. Assessments and historical information will be reviewed to develop preliminary standard costing information for remediation, monitoring and retirement costs. We will continue to discuss this status of this standard with management and share thought leadership as it becomes available.

Appendices

Content

Appendix 1: Required communications

Reports to the Audit Committee

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

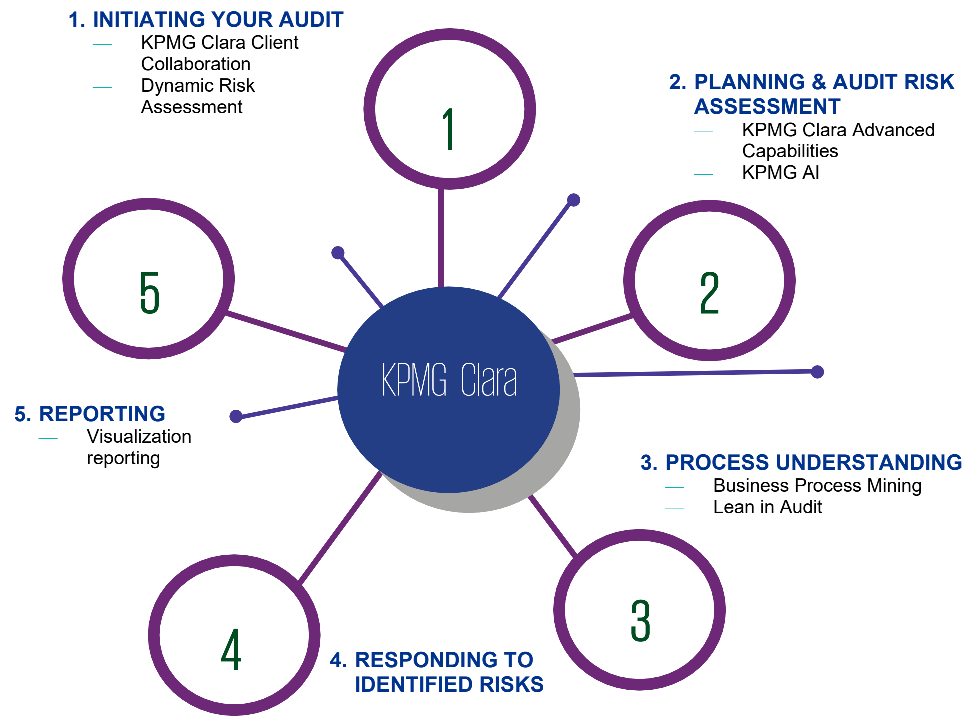
Appendix 2: Use of technology in the audit

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.

Lean techniques allow your team 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: Current developments - new accounting standards

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

Standard	Key observations
Asset Retirement Obligations	– A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2022 *(for City's 2023 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 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, 2023 (*for City's 2024 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.

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. Release 1 exposure draft related to discount rate guidance and deferral provisions is expected to be issued in 2021 for stakeholder consultation.
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. – An Exposure Draft (“ED”) was issued in November 2019 which proposes new requirements for recognizing, measuring and classifying infrastructure procured through a public private partnership. – The ED 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 to the future economic benefits and risks of the infrastructure asset, and it controls any significant residual interest in the infrastructure at the end of the P3’s term. – The ED 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 initially measured at its fair value, as P3’s are the result of a competitive bidding process, cost should be equal to the asset’s fair value on day one of the transaction. A liability, when it exists, should be initially measured at the same amount as the infrastructure asset. Cost would be measured by discounting the expected cash flows by a discount rate that is the contract rate.

Appendix 6: Audit and Assurance Insights

Our latest thinking on the issues that matter most to audit committees, board of directors and management.

Featured insight	Summary
KPMG Audit & Assurance Insights	Curated research and insights for audit committees and boards
Accelerate	The key issues driving the audit committee agenda in the time of COVID-19
Board Leadership Centre	Supporting you in your Director role
Current Developments	Series of quarterly publications for Canadian businesses including Spotlight on IFRS, Canadian Securities & Auditing Matters and US Outlook.
KPMG Global IFRS Institute	The latest news, insights and guidance for boards, audit committee members, investors and all stakeholders about the evolving global financial reporting framework.
KPMG Climate Change Financial Reporting Resource Centre	Our climate change resource centre provides FAQs to help you identify the potential financial statement impacts for your business.
You can't go green without blue - The blue economy is critical to all companies' ESG ambitions	In this report, we consider how leading corporates and investors can take action to capture the value that can be found in a healthy, sustainable ocean economy.

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