SUBJECT: 2005 External Audit Plan and Fees (FCS06014) (City Wide)

EXECUTIVE SUMMARY:

Grant Thornton, Chartered Accountants, audit approach and scope of audit work for the City of Hamilton and its related entities for the 2005 fiscal year is provided in the attached 2005 External Audit Plan Communication. The Audit Plan communicates to the oversight body Grant Thornton’s overall audit responsibilities and audit approach in accordance with Canadian generally accepted auditing standards. New auditing standards from the Canadian Institute of Chartered Accountants (“CICA”) focus the audit on areas where there is greater risk of misstatement. Grant Thornton has tailored their audit of the City to several specific audit areas, including taxation, water and wastewater revenues, grants and subsidies, significant estimates, purchases and payables and employee compensation.
Grant Thornton will be discussing the audit work required on the financial statements for HECFI, Library and Housing with the respective boards.

Grant Thornton has advised the City and its related boards that the audit fee for the 2005 fiscal year will increase from last year’s fee of $154,700 to $172,550 (plus applicable taxes). The audit fees for all of the 2005 audits are summarized in the chart below and in Grant Thornton’s report.

**BACKGROUND:**

Grant Thornton was appointed the City’s external auditor by Council at its meeting on May 15, 2001 (FCS01038) for a period of five years for an annual fixed fee of $110,500 plus applicable taxes. The audit fee was subject to annual review to reflect changes in the scope of the audit work.

Changes to the scope of audit work due to new CICA audit standards and changes to the number of programs requiring audits have increased the City of Hamilton’s audit fee to $172,550 for the 2005 audit. The increase in the audit fees can be summarized as follows:

- **2002 Audit - Additional audits and changes in CICA audit standards** $33,650
  Changes include additional audits for two business improvement areas (+$1,000), Federal Government's Supporting Communities Partnership Initiative (“SCPI”) financial report (+$5,000), Provincial Offences financial report (+$3,500) and CICA improvements to the requirements for auditor’s communication with oversight bodies as a result of changes in the business environment (i.e. Enron and Worldcom) (+$24,150)

- **2003 Audit – Increase in scope of audit work for HECFI** $1,500

- **2004 Audit – Additional audits and changes in CICA standards** $9,050
  Changes include additional audits for Tourism Hamilton (+$3,000), increase in scope of work for Provincial Offences financial report (+$500), reduction in the number of housing corporation audits (-$4,000) and further changes to audit standards in CICA handbook (+$9,550)

- **2005 Audit – Additional audits and changes in CICA standards** $17,850
  Changes include additional audits for phase II of the Federal Government’s Supporting Communities Partnership Initiative (“SCPI”) financial report (+$5,500) and further changes to audit standards in CICA handbook (+$12,350)

The City of Hamilton 2005 External Audit Plan Communication from Grant Thornton provides more details of the roles and responsibilities of the auditors, the Strategic Planning & Budgets Committee as the audit committee and City of Hamilton management and staff and the expected completion date of the 2005 audited financial statements.
ANALYSIS/RATIONALE:

Management met with Grant Thornton to discuss the 2005 External Audit Plan and reaffirmed the commitment to completing the financial statements in time for the start of the audit work on April 3, 2006. Staff have developed an internal 2005 Year End Plan assigning responsibilities to individual directors, managers and other staff.

The following table summarizes the 2005 Audit Fees:

<table>
<thead>
<tr>
<th>Audit Requirement</th>
<th>2001 Base Fee Per Proposal in FCS01038</th>
<th>2002 Audit Fee per FCS03041 (note 2)</th>
<th>2003 Audit Fee per FCS04018</th>
<th>2004 Audit Fee FCS05025 (note 3)</th>
<th>2005 Audit Fee (note 4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Hamilton Consolidated Financial Statements</td>
<td>$35,200</td>
<td>$46,200</td>
<td>$46,200</td>
<td>$50,700</td>
<td>$55,200</td>
</tr>
<tr>
<td>City of Hamilton Trust Funds and Sinking Funds</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
<td>3,750</td>
<td>4,500</td>
</tr>
<tr>
<td>Other audits (Provincial and Federal Government Programs)</td>
<td>9,800</td>
<td>18,300</td>
<td>18,300</td>
<td>19,000</td>
<td>24,500</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td><strong>$48,000</strong></td>
<td><strong>$67,500</strong></td>
<td><strong>$67,500</strong></td>
<td><strong>$73,450</strong></td>
<td><strong>$84,200</strong></td>
</tr>
<tr>
<td>HECFI (note 1)</td>
<td>$8,500</td>
<td>$11,500</td>
<td>$13,000</td>
<td>$14,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Hamilton Public Library Board (note 1)</td>
<td>3,500</td>
<td>4,000</td>
<td>4,000</td>
<td>5,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Housing Corporations (note 1, 3)</td>
<td>27,000</td>
<td>34,000</td>
<td>34,000</td>
<td>30,000</td>
<td>32,500</td>
</tr>
<tr>
<td>Tourism Hamilton</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,000</td>
<td>3,500</td>
</tr>
<tr>
<td>Canadian Football Hall of Fame and Museum and CANUSA Games</td>
<td>3,500</td>
<td>4,500</td>
<td>4,500</td>
<td>5,500</td>
<td>6,500</td>
</tr>
<tr>
<td>Business Improvement Areas</td>
<td>8,000</td>
<td>10,650</td>
<td>10,650</td>
<td>11,750</td>
<td>12,850</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td><strong>$62,500</strong></td>
<td><strong>$76,650</strong></td>
<td><strong>$78,150</strong></td>
<td><strong>$81,250</strong></td>
<td><strong>$88,350</strong></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$110,500</strong></td>
<td><strong>$144,150</strong></td>
<td><strong>$145,650</strong></td>
<td><strong>$154,700</strong></td>
<td><strong>$172,550</strong></td>
</tr>
</tbody>
</table>

NOTES:
1: The audit fees for these entities are subject to approval by the respective boards.
2: The 2002 Audit Fee increased from the 2001 Base Fee as a result of additional audits in 2001 of $9,500 and an increase in scope of audit work in 2002 of $24,150 as outlined in report FCS03041.
3: The 2004 Audit Fee reflects an increase in scope of work in 2004 for a new audit of Tourism Hamilton (+$3,000), increase in scope of work for Provincial Offences (+$500), new audit standards (+$9,550) and a reduction in the number of audits for the Housing Board as a result of amalgamation (-$4,000).
4: The 2005 Audit fee reflects an increase in scope of work for the audit of SCPI (+$5,500) and changes to audit standards (+$12,350).

The audits of some other entities that are not included in this schedule are Horizon Utilities Inc, Hamilton Renewable Power Inc, Hamilton Conservation Authority, Hamilton International Airport and Mohawk 4Pad Ice Centre.

ALTERNATIVES FOR CONSIDERATION:

N/A.
FINANCIAL/STAFFING/LEGAL IMPLICATIONS:

There are sufficient funds in the 2005 current budget to fund the increase in the 2005 audit fees. Any additional time required by the external auditors during the course of the 2005 year end audit will be communicated to City staff before the additional work is commenced. The resulting additional audit fees will be billed separately.

POLICIES AFFECTING PROPOSAL:

N/A.

RELEVANT CONSULTATION:

The 2005 External Audit Plan from Grant Thornton and the City of Hamilton 2005 Year End Plan has been discussed with staff and management of all of the City’s departments and boards. Grant Thornton has prepared similar 2005 External Audit Plans for the Hamilton Public Library, HECFI and Housing and they will be having discussions with the respective staff. City staff will be advising CANUSA Games, the Canadian Football Hall of Fame and Museum and the Hamilton Association of Business Improvement Areas of 2005 audit fees.

CITY STRATEGIC COMMITMENT:

By evaluating the “Triple Bottom Line”, (community, environment, economic implications) we can make choices that create value across all three bottom lines, moving us closer to our vision for a sustainable community, and Provincial interests.

Evaluate the implications of your recommendations by indicating and completing the sections below. Consider both short-term and long-term implications.

**Community Well-Being is enhanced.** ☑ Yes ☐ No

The 2005 External Audit Plan Communication from the external auditors provides the City’s elected officials with information to carry out their oversight responsibilities for financial reporting. The subsequent audit of the financial statements ensures that public activities are reported and decisions at all levels of government are co-ordinated, efficient, effective and easily accessible to all citizens.

**Environmental Well-Being is enhanced.** ☐ Yes ☑ No

**Economic Well-Being is enhanced.** ☑ Yes ☐ No

The 2005 External Audit Plan is prepared to ensure fiscal accountability of the City to the ratepayers and contributes to Council’s strategic goals as a City that spends wisely and invests strategically. The External Audit Plan Communication from the external auditors reinforces the responsibilities of the elected officials and management in ensuring that the organizations financial resources are being protected and economic well-being is enhanced.

**Does the option you are recommending create value across all three bottom lines?** ☐ Yes ☑ No

**Do the options you are recommending make Hamilton a City of choice for high performance public servants?** ☑ Yes ☐ No

The external audit plan and the year end planning processes ensure that staff and management are aware of the responsibilities for the audit and financial reporting. Staff continually develop the skills required for these changing responsibilities to create an interesting workplace which makes the City a desirable place of employment.
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</tbody>
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### APPENDICES

APPENDIX A - RECENT ACCOUNTING, FINANCIAL REPORTING AND AUDITING DEVELOPMENTS

APPENDIX B - INDEPENDENCE LETTER
1. Objective of This Report

The objective of this report is to communicate our overall audit responsibilities and audit approach with those having oversight responsibility for the financial reporting process at the City of Hamilton (“City”) in accordance with Canadian generally accepted auditing standards (“Canadian GAAS”). This audit plan forms part of our ongoing communication with the Audit Committee in accordance with the requirements of the CICA Handbook, “Communications with those having oversight responsibility for the financial reporting process”.

We view the development of our audit service plan as an important process that provides all parties to the audit process with an opportunity to assess the audit needs, focus areas, approach and expectations for performance. Our audit strategy has been developed based on our knowledge and experience in the municipal sector, as well as discussions with management regarding the organization and developments during the current year. This plan will be subject to change as we evaluate additional information and assess the results of our procedures completed during the course of our work.

In this document we also outline current accounting and reporting issues for the City’s consideration in the preparation of the consolidated financial statements for 2005 and future years.

This report is intended solely for the information and use of the Strategic Planning and Budgets Committee, the Mayor and Council, management, and others within the City and should not be used by anyone other than these specified parties or for any other purpose.
2. **Current Business Environment**

There have been a number of recent and highly publicized business failures, which have called attention to the role and responsibilities of management, Boards of Directors, Audit Committees and auditors. Corporate governance has evolved into a critical issue for regulators, management and the general public.

The current business environment is characterized by the following:

◊ Unprecedented focus on high-quality, transparent financial reporting;
◊ Increasingly complex and voluminous financial reporting requirements;
◊ Expanding disclosure requirements;
◊ Increasingly complex and sophisticated business transactions and structures;
◊ High profile irregularities and restatements intensifying interest by regulators and others who rely on the financial statements;
◊ Greater competency requirements for those responsible for governance (i.e. Council, Strategic Planning and Budget Committee).

New standards and guidance have been introduced by law makers, regulators and professional bodies in North America in an attempt to address the increased expectation for clearer financial reporting and responsibilities. In particular, recent releases of new reporting and governance requirements for public companies have placed significant emphasis on the proper oversight of financial reporting. While the most significant and publicized requirements relate to publicly traded companies, the changing business environment is impacting on the expectations of all “publicly accountable” organizations, including municipalities. These changes are manifesting themselves within the municipal movement by way of heightened stakeholder expectations and scrutiny of governance processes, internal controls and financial reporting.

As a result of the changing environment, Corporate Governance is important to all entities. It is important for governing bodies to understand their responsibilities in these areas.
3. Governance Responsibilities

The role of the Strategic Planning and Budgets Committee, acting as an audit committee, is central to ensuring the integrity of financial information. Audit Committees are expected to be actively involved in overseeing financial reporting and satisfying themselves that an entity’s financial reports are comprehensive, reliable, understandable and responsive to the needs of the readers. Audit Committees should understand the municipal government environment, the basic structure of transactions, their business purpose, and the significant implications. In overseeing financial reporting, it is not only important to rely on the information provided but also to challenge, analyze, interpret and evaluate the information.

The importance of the need for effective Corporate Governance has been heightened in the minds of stakeholders. There is an expectation that individuals who sit in oversight roles will act with sufficient discipline and enact robust processes to execute their duties effectively. It is well understood that the Audit Committee sets the tone for the control environment, and the Committee’s actions are important in establishing the culture of control for the entity.
4. MANAGEMENT RESPONSIBILITIES

The operations of the City are under the control of management, who act under the guidance of those charged with governance of the City and therefore, those having oversight responsibility for the financial reporting process, namely, the Strategic Planning and Budgets Committee.

Management has the primary responsibility for the accurate recording of transactions and the preparation of consolidated financial statements and the accompanying notes in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Being responsible for preparing the financial statements includes responsibilities relating to internal control, such as designing and maintaining accounting records, selecting and applying accounting policies, safeguarding assets and preventing and detecting error and fraud. Likewise, management is responsible for identifying and ensuring that the City complies with the laws and regulations applicable to its activities and to prevent and detect illegal acts.

Management is also responsible for assessing the impact of any audit differences detected during the preparation and audit of the consolidated financial statements, individually and in aggregate, on the fair presentation of amounts and disclosures contained in those financial statements and determining adjustments needed.
Grant Thornton LLP has been engaged to examine the consolidated financial statements of the City of Hamilton as at and for the year ending December 31, 2005. We will perform our audit in accordance with Canadian generally accepted auditing standards.

In addition to the audit of the City’s consolidated financial statements, we will be performing the following associated engagements:

◊ We will audit and report on the statement of financial position of the following entities as at December 31, 2005 and the statements of financial activities, and changes in financial position for the year then ended;

♦ Housing corporations – 4 entities
♦ Hamilton Entertainment and Convention Facilities Inc. and Hamilton Performing Arts Foundation
♦ Hamilton Public Library Board
♦ Business Improvement Areas (BIAs) – 11 entities
♦ Canusa Games
♦ Pension Plans – 3 entities
♦ Canadian Football Hall of Fame
♦ City of Hamilton Trust Funds and Sinking Funds
♦ Health Programs and other Federally and Provincially Funded Programs
♦ Tourism Hamilton
♦ Connect Hamilton – Create Community
♦ Hamilton Renewable Power Incorporated

It should be noted that Grant Thornton is not appointed auditor for the City’s controlled subsidiary, Horizon Utilities Corporation.
5.1 Responsibility of the External Auditor

As independent auditors of the City of Hamilton for the year ending December 31, 2005, we are responsible for performing our audit and preparing our auditors’ report in accordance with Canadian GAAS in order to report to Council, through the Audit Committee, and to express an opinion that, based on our audit, the City’s consolidated financial statements present fairly, in all material respects, the financial position of the City and the results of its operations and its cash flows in conformity with Canadian GAAP. As auditors of the City, we can make suggestions as to the content and the form of the financial statements. However, the financial statements remain representations made by management and those charged with governance, namely, the Audit Committee.

In order to fulfill our responsibilities under Canadian GAAS, we will perform the following:

◊ Assess the risk that the financial statements may contain differences that individually or in the aggregate, are material to the financial statements taken as a whole;
◊ Examine, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
◊ Assess the accounting principles used and their application;
◊ Assess the significant estimates made by management;
◊ Evaluate the overall financial statement presentation; and
◊ Communicate with the Strategic Planning and Budgets Committee matters specifically set out in Canadian GAAS and other matters that have a significant effect on the qualitative aspects of accounting principles used in the City’s financial reporting.

◊ An audit is performed to obtain reasonable, though not absolute assurance as to whether the financial statements are free of material misstatement, whether caused by fraud or error. Absolute assurance in auditing is not attainable as a result of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature.

◊ Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with Canadian
GAAS. Further, because of the nature of fraud, including intentional misstatements concealed through collusion and forgery, an audit designed and executed in accordance with Canadian GAAS may not detect a material misstatement arising from fraud. If circumstances exist that indicate that there may be a material misstatement in the financial statements resulting from fraud or error, we would perform procedures to either confirm or dispel our suspicions that the financial statements are materially misstated resulting from fraud or error.

If we were to identify a difference resulting from error or change in estimate, other than a trivial difference, we would communicate the difference to the appropriate level of management on a timely basis and to the Strategic Planning and Budgets Committee whether or not the error has been corrected. We will inform the Strategic Planning and Budgets Committee of those uncorrected misstatements aggregated during our audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

If we were to identify a fraud, whether or not it results in a material misstatement in the financial statements, or obtain evidence that indicates that fraud may exist, even if the potential effect on the financial statements would not be material, we would communicate these matters promptly to the appropriate level of management and to the Strategic Planning and Budgets Committee.

An audit conducted in accordance with Canadian GAAS does not provide assurance about an entity's compliance with the laws and regulations that may affect it. Accordingly, an auditor conducting an audit in accordance with Canadian GAAS may not detect an illegal act, or recognize an act as being illegal, even if the effect of its consequences on the financial statements is material. However, if we obtained evidence, which indicates an illegal, or possibly illegal act, other than one considered inconsequential, may have occurred, we will ensure the Strategic Planning and Budgets Committee and appropriate levels of management are informed.

As part of our audit, we must obtain an understanding of internal control sufficient to plan the audit and, when control risk is assessed below maximum, gather sufficient appropriate audit evidence through tests of controls to support our assessment of control risk. However, such procedures are directed towards internal control that is relevant to the audit and are designed to support the expression of our opinion on the financial statements. Accordingly, they are neither intended nor sufficient to provide assurance or to express an opinion to the City with respect to the effectiveness or efficiency of its internal control, or any systems, or part of systems thereof, or to identify significant...
deficiencies. However, we are responsible for communicating to the Strategic Planning and Budgets Committee significant weaknesses in internal control that come to our attention during the course of the financial statement audit.

Concurrently with our audit, we will:

◊ Be alert to concerns of management and the Strategic Planning and Budgets Committee and respond thereto;

◊ Keep management and staff of the City, as well as the Strategic Planning and Budgets Committee abreast of recent accounting, financial reporting, auditing developments and regulatory requirements issued during the year by the Canadian Institute of Chartered Accounts (“CICA”), which could have an impact on the City’s consolidated financial statements;

◊ Prepare recommendations, if any, to improve internal control and administrative efficiency for submission to management and the Strategic Planning and Budgets Committee.

5.2 **General Approach to the Audit**

Our audit approach is a risk-based approach, which enables us to concentrate our efforts on the operating cycles, financial statement items and assertions of greatest risk of misstatement. Review and appraisal of the various business risks and processes impacting the City’s consolidated financial statements, and determining the appropriate audit procedures to bring our audit risk to an acceptable level are critical steps in our planning process. The risks referred to are those that impact on financial reporting and are not a comprehensive collection and analysis of the entire risk profile for the City.

During the planning process, we identify those transaction cycles that are likely to have the most risk of a material misstatement as critical cycles. Designating a cycle as critical does not necessarily mean that problems are anticipated and areas may be so identified even though no major problems are expected. Each cycle has a number of assertions, such as existence, completeness and valuation. The same degree of risk of material misstatement does not necessarily apply to all assertions within a critical cycle. Therefore, our judgment as to critical cycles is further refined to the assertion level within a critical cycle.
5.3 Audit Risk

Audit risk is defined as the risk that a material misstatement exists in the financial statements and will not be detected by our audit procedures. Audit risk includes the following components:

a) Inherent risk, which is the risk of a material misstatement occurring in the first place;

b) Control risk, which is the risk that an organization’s system of internal control will not prevent or detect a material misstatement;

c) Detection risk, which is the risk that a material misstatement that has not been corrected by an organization’s system of internal control will not be detected by us.

Inherent risk and control risk exist independently of the audit, and are functions of an entity and its’ economic and control environments, regardless of whether an audit is conducted. Detection risk relates to the nature, extent and timing of our audit procedures.

We assess inherent and control risks to enable us to design sufficient substantive procedures to reduce risk to a level that, in our judgment, results in an appropriate level of audit risk. There remains a risk that errors will not be found due to inherent limitations of auditing procedures (eg. sampling) and the fact that all relevant information may not be made available to us.

5.4 Materiality

Materiality refers to the magnitude or nature of a misstatement, including an omission, of financial information either individually or in aggregate that, in light of surrounding circumstances, makes it probable that the judgment and/or decision of a reasonable person relying on the information would have been influenced as a result of the misstatement. Grant Thornton uses planning materiality to determine the extent of substantive audit procedures.

Auditing Guideline No. 31, Applying Materiality and Audit Risk Concepts in Conducting an Audit, was issued as guidance in January 2002. This guideline provides clarification of the factors to be considered in applying materiality and emphasizes the greater use of professional judgment to assess errors versus reliance focused on quantitative assessments. There is also more guidance on assessing qualitative factors that affect
materiality and on assessing the effect of misstatements on financial statements. These changes arose in large part due to concerns over “earnings management” by entities. There is now less tolerance for unadjusted identified misstatements, regardless of amount.

Grant Thornton has set planning materiality for the 2005 audit at $2,600,000. It is important to note that this is a guidance amount used for sampling and overall financial statement evaluation purposes only. It is not indicative of the magnitude of the transaction sizes evaluated or the thresholds used, along with qualitative factors, for error evaluation purposes. We will use a lower working materiality in considering whether any audit differences detected during the audit, either individually or in the aggregate, are significant. In our year-end report to the Strategic Planning and Budgets Committee, we will summarize all non-trivial audit differences (i.e., individual items greater than $52,000) that come to our attention, including those that are subsequently adjusted by management.
### 5.5 Specific Audit Plan

The risk areas we have identified and that we will address during the 2005 audit and our audit approach with respect thereof are as follows:

<table>
<thead>
<tr>
<th>Risk Areas</th>
<th>Audit Approach</th>
</tr>
</thead>
</table>
| Taxation                                        | - Confirmations of taxes receivable as at December 31, 2005 (statistical sample);  
                                                  - Recalculation of the net taxable assessment based on verified assessment rolls and approved levies;  
                                                  - Assess adequacy of allowance for doubtful accounts by testing subsequent receipts, reviewing management estimates and examining the value of underlying property. |
| Water and Sewer Revenues                        | - Documentation of systems and testing of identified controls;  
                                                  - Review of supporting documentation for year end balances;  
                                                  - Analytical review.                                                                                                                                 |
| Public Health and Community Services Grants and Subsidies | - Review of the completeness and appropriate allocation of funds between fiscal periods, particularly given the strong need for enhanced reconciliation controls and processes around provincial and federal grants and audit differences noted in prior years. |
| Purchases and Payables                          | - Using data extraction software, perform sophisticated audit procedures around purchases (i.e., large or unusual payments, compliance with purchasing policies).  
                                                  - Review supporting documentation and management estimates with respect to the completeness and accuracy of significant year-end accruals.  |
Risk Areas | Audit Approach
---|---
- Provisions for employment benefits and landfill closure | - Review assumptions used by management;  
- Test supporting documentation (i.e. actuarial valuations) relating to the various amounts and disclosures.

- Commitments and contingencies | - Verify accuracy and reasonableness of amounts and disclosures, with reference to correspondence with lawyers, examination of supporting documentation, and discussions with management.

We will use analytical review procedures, mainly for the audit of operating fund activity, to identify trends in the revenues and expenditures, and to compare variations between the accounts from one period to the next and between actual results and budgeted results. We will investigate significant variations to assure ourselves that the variations are not caused by possible material misstatements.

**Reliance on Other Professionals**

Grant Thornton is required to place reliance on other professionals for purposes of gathering audit evidence and expressing an opinion on the consolidated financial statements for the City of Hamilton. The City utilizes the work of an actuary for the determination of liabilities associated with employee benefits.

In addition, another firm of chartered accountants audits the consolidated financial statements of Horizon Utilities Corporation.

**Assistance from City Staff**

A list of working papers required for the conduct of our audit has been prepared and provided to Mr. Joe Rinaldo, General Manager, Finance and Corporate Services. We have also provided select templates in the past to further clarify information requirements and assist various departments in the overall year-end reporting process. We would expect that City staff continue to use these templates for the 2005 audit.
6. MANAGEMENT OF THE AUDIT

6.1 Timing of the Audit

We are planning to perform our audit in accordance with the time schedule indicated below:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preliminary planning and meetings with management (financial results and budgets, minutes, risk management activities)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Documentation and evaluation of governance processes and controls (including IT systems).</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Elaboration of the audit strategy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Document understanding of significant cycles (taxation, purchasing, payroll, water and sewer revenue, grants)</td>
<td></td>
<td></td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit planning for related entities (Library, HECFI, Housing, BIAs)</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Confirmation of taxes receivable as at December 31, 2005</td>
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<td>✓</td>
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<tr>
<td>Presentation of our audit plan to the Strategic Planning and Budgets Committee</td>
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<tr>
<td>Audit of year-end balances and financial statements of related entities</td>
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<tr>
<td>Audit of year-end balances and consolidated financial statements</td>
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<tr>
<td>Presentation of the results of our audit to the Strategic Planning and Budgets Committee</td>
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<td></td>
<td>✓</td>
</tr>
<tr>
<td>Presentation of the management letter for the year ending December 31, 2005 to the Strategic Planning and Budgets Committee</td>
<td></td>
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<td></td>
<td></td>
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<td>✓</td>
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<tr>
<td>Review of the annual report</td>
<td></td>
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<td>✓</td>
</tr>
</tbody>
</table>

This anticipated timing is contingent on draft financial statements and all supporting working papers being ready for audit by April 3, 2006.
6.2 Audit Team

The 2005 audit engagement will be carried out under the responsibility of:

- **Audit Partner**: Evan McDade, CA, CBV
- **Concurring Audit Partner**: Thane MacKenzie, CA
- **Senior Manager**: Melanie Dugard, CA
- **Audit Senior**: Rick Huneault
- **Technology Risk Management**: James Knott
- **Commodity Tax Specialist**: Sean Kelly

We realize the importance of staff continuity in the services we provide. Through continuity, our people gain the knowledge of previously addressed accounting and reporting practices so that efficiencies are achieved and maintained. Most of the senior personnel noted above represent continuity from the 2004 audit, many of whom were also involved in prior years’ audits.

6.3 Professional Fees

*Estimates and Assumptions*

Our audit plan ensures that the City benefits from an efficient and effective audit. Our approach focuses on planning and coordinating our work with the City’s management and is dependant on the full cooperation of City personnel in preparing adequate information required for the audit on a timely basis.

The estimated fee includes all audit related services as itemized in Section 5 of this document (*Scope of the Audit*), and all additional audit work in the current year with respect to the proposed changes to auditing standards, as referenced in Section 5.2 of this document (*General Approach to the Audit*) and outlined in Appendix A.

This fee estimate is based on our audit plan, and reflects our best estimate of the time that will be required to complete the audit, given the nature and size of the City’s operations, and the assistance we have received and expect to receive from financial and non-financial management. Any significant changes to the audit plan or new transactions or issues would result in an increase in our estimated fees.
The estimated fees for the 2005 audit are as follows given the impact of the new audit requirements, as well as time for meetings and communication with the Audit Committee.

<table>
<thead>
<tr>
<th>Entity</th>
<th>2004 Fee</th>
<th>Increase to scope</th>
<th>2005 Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Hamilton</td>
<td>$ 50,700</td>
<td>$4,500</td>
<td>$ 55,200</td>
</tr>
<tr>
<td>Housing Corporations (4) (net of 20% decrease due to amalgamation)</td>
<td>30,000</td>
<td>2,500</td>
<td>32,500</td>
</tr>
<tr>
<td>HECFI</td>
<td>14,000</td>
<td>1,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Hamilton Public Library Board</td>
<td>5,000</td>
<td>1,000</td>
<td>6,000</td>
</tr>
<tr>
<td>BIAs (11)</td>
<td>11,750</td>
<td>1,100</td>
<td>12,850</td>
</tr>
<tr>
<td>Canusa Games</td>
<td>2,000</td>
<td>500</td>
<td>2,500</td>
</tr>
<tr>
<td>Pension Plans – 3 entities</td>
<td>12,000</td>
<td>-</td>
<td>12,000</td>
</tr>
<tr>
<td>Canadian Football Hall of Fame</td>
<td>3,500</td>
<td>500</td>
<td>4,000</td>
</tr>
<tr>
<td>Trust Funds and Sinking Funds</td>
<td>3,750</td>
<td>750</td>
<td>4,500</td>
</tr>
<tr>
<td>Health Programs &amp; other Federally and Provincially Funded programs (Connect Hamilton, long term care etc.)</td>
<td>14,500</td>
<td>-</td>
<td>14,500</td>
</tr>
<tr>
<td>Tourism Hamilton</td>
<td>3,000</td>
<td>500</td>
<td>3,500</td>
</tr>
<tr>
<td>Provincial Offences Act</td>
<td>4,500</td>
<td>-</td>
<td>4,500</td>
</tr>
<tr>
<td><strong>Total, per 2004 planning document</strong></td>
<td><strong>154,700</strong></td>
<td><strong>12,350</strong></td>
<td><strong>167,050</strong></td>
</tr>
<tr>
<td>SCPI II</td>
<td>5,500</td>
<td>-</td>
<td>5,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$160,200</strong></td>
<td><strong>$12,350</strong></td>
<td><strong>$172,550</strong></td>
</tr>
</tbody>
</table>

Any additional time incurred in areas such as significant issues, related accounting assistance or dealing with new accounting standards, including assisting with financial statements and notes, are additional to the base fee and thus will be billed separately. No work will proceed without management’s concurrence.
Our Relationship with City of Hamilton

Canadian GAAS requires that we communicate, at least annually, with those having oversight responsibility for the financial reporting process, namely, the Strategic Planning and Budgets Committee, regarding all relationships between the City and us that in our professional judgment, may reasonably be thought to bear on our independence.

We confirm that we are not presently aware of any relationship or non-audit services that would impair our independence for purposes of expressing an opinion on the consolidated financial statements. We discuss our relationship with the City in our independence letter, included as Appendix B to this report.

During our audit, we will communicate any significant new matters at the time the relationship is established or the matter is first identified. At the completion of the audit, we will reconfirm our independence to the Strategic Planning and Budgets Committee.
City of Hamilton
Report to the Strategic Planning and Budgets Committee
January 2006

— APPENDICES —

Grant Thornton
City of Hamilton
Report to the Strategic Planning and Budgets Committee
January 2006

APPENDIX A.
A. Recent accounting, financial reporting and auditing developments

The following accounting, financial reporting and auditing pronouncements have been issued during the year that are susceptible to affect the presentation of the City’s consolidated financial statements for the year ending December 31, 2005 or future years:

**Tangible Capital Assets**

In June 2005, PSAB approved a draft of PS 3150, standards on how to account and report Tangible Capital Assets. This section includes definitions given to tangible capital assets held for use, used on a continuing basis, with life beyond one year, and not intended for resale.

The Public Sector Accounting (PSA) Handbook does not currently provide standards for accounting for capital assets for local governments. However, tangible capital assets do have a future economic benefit, and therefore, the stock of tangible capital assets needs to be reported. Local governments do not have a generally accepted definition of what is a tangible capital asset. Items included in tangible capital assets vary from province to province and among local governments within provinces.

Tangible capital assets will include betterments, contributed assets and infrastructure (roads, bridges and water and sewer systems). It will exclude works of art.

Final approval of the exposure draft is now expected by November 2006. It is expected that this section will become effective for fiscal years beginning January 1, 2008.

**Generally Accepted Accounting Principles (GAAP)**

PSAB proposed, subject to comments, to issue new Handbook section PS 1150, Generally Accepted Accounting Principles.

The section is intended to clarify GAAP for the public sector. This would include primary sources of GAAP for governments and the criteria that must be satisfied in determining another source of GAAP when a primary source is not available. This section was approved in February 2005 and applies to fiscal years beginning on April 1, 2005.

**Measurement Uncertainty**

PSAB approved a new PS Handbook section Measurement Uncertainty, which applies to all levels of government. This section provides a definition of measurement uncertainty and
disclosure requirements. The section is effective for fiscal years beginning on or after April 1, 2005.

**Sale-Leaseback Transactions**

PSAB approved PS Guideline PSG-5, Sale-Leaseback Transactions – Expense-Based in June 2005. The key proposals are as follows:

- To depart from the existing ‘interdependence’ approach to accounting for sale-leaseback transactions where it is assumed that the terms of the sale and the leaseback are not able to be objectively separated
- To recommend a ‘components’ approach that assumes the sale transaction can be separated objectively from the leaseback transaction
- To permit only assets and liabilities that meet their definitions in section PS 1000 to be presented on the statement of financial position
- Where the leaseback constitutes a leased tangible capital asset, the transaction is in substance a financing arrangement
- Where the leaseback constitutes an operating lease, it is in substance a sale of the property

Prospective application is required for fiscal years beginning on or after April 1, 2005. Comparative numbers should be restated and reclassified as necessary to conform with the new presentation.

**Financial Statement Presentation**

Prospective application for fiscal years beginning on or after April 1, 2005 (comparative numbers should be re-stated and reclassified as necessary to conform to the new presentation)

The section recommends general reporting principles and standards for the disclosure of information in government financial statements and includes reporting the change in net debt and reporting the legislative control and financial accountability
Auditing Developments

Exposure Draft – Audit Risk

The CICA recently issued an exposure draft on assessing audit risk. The proposed standards are based on existing international standards issued by the International Auditing and Assurance Standards Board (IAASB). The proposed standards will harmonize Canadian standards with the IAASB standards. The CICA standards become effective for all audits of financial statements for periods ending on or after December 15, 2005.

The primary objective of the audit risk standards is to enhance how auditors work with and apply the audit risk model. Examples of the enhancements include:

a) A requirement for a more in-depth understanding of the entity and its environment, including the plans and actions resulting from the assessment of business risks and their effect on financial reporting.

b) A requirement to document internal controls over financial reporting for all audits, regardless of the audit approach.

c) A requirement to assess the effectiveness of the design of internal controls against an internal control framework, also regardless of the audit approach. In addition, the standards encourage the auditor to test controls in order to assess their operating effectiveness.

d) A requirement to directly link the assessed audit risks with the nature, timing and extent of audit procedures performed in response to those risks.

e) Expanded documentation requirements.

The goal of these standards is to improve audit quality by providing the auditor with information to enhance the design and performance of audit procedures. The new requirements are intended to provide increased rigor to the auditor’s procedures, and to enhance the auditor’s knowledge, by requiring the auditor to obtain information not only from people directly involved in financial reporting and management, but also those with operational roles within the entity. The direct link between assessed risks and audit procedures is expected to enhance the focus of the audit on areas where there is a greater risk of misstatement.

The Auditor’s Responsibility to Consider Fraud and Error

In April 2004, the AASB approved revisions to Handbook Section 5135, The Auditor’s Responsibility to Consider Fraud and Error. The Section is derived from International

The principal changes to Section 5135 include the following:

◊ A requirement for members of the engagement team to discuss the susceptibility of the entity’s financial statements to material misstatement due to fraud or error, and a requirement for the engagement partner to consider which matters are to be communicated to members of the engagement team not involved in the discussion;

◊ More specific guidance on enquiries of management and others within the entity on the risk of fraud;

◊ A requirement to design and perform certain mandatory procedures to address the risk of management override of internal controls, including examining journal entries, reviewing accounting estimates for bias and evaluating the business rationale for significant unusual transactions;

◊ A presumption that there is ordinarily a risk of fraud in revenue recognition, a requirement to perform further procedures if the risk is present and a requirement to document the reasons when the auditor has not identified revenue recognition as a risk;

◊ A requirement to incorporate an element of unpredictability in the selection of the nature, extent and timing of the audit procedures performed in response to assessed risks of material misstatement due to fraud;

◊ Significantly more detailed documentation requirements;

◊ Removal of the assumption of management’s good faith.
APPENDIX B.
November 25, 2005

The Strategic Planning and Budgets Committee
City of Hamilton

Dear Committee members:

We have been engaged to audit the consolidated financial statements of the City of Hamilton (The City) for the year ended December 31, 2005.

Canadian generally accepted auditing standards (CICA Handbook section 5751) require that Grant Thornton LLP communicate at least annually with the Committee regarding all relationships between the City and Grant Thornton that, in our professional judgment, may reasonably be thought to bear on our independence.

In determining which relationships to report, the Guideline requires us to consider relevant rules and related interpretations prescribed by the appropriate provincial institute and applicable legislations, covering such matters as:

(a) Holding a financial interest, either directly or indirectly, in a client;
(b) Holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
(c) Personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
(d) Economic dependence on a client and
(e) Provision of services in addition to the audit engagement.

We are not aware of any relationships between the City and Grant Thornton that, in our professional judgment, may reasonably be thought to bear on our independence, which have occurred from January 1, 2005 to November 25, 2005.

With respect to item (e) provision of services in addition to the audit engagement, the total of invoices remitted to the City during the period from January 1 to November 25 were as follows:

- Audit Services$ 153,200
- Health Programs $ 15,100
- Bookkeeping $ 7,500

1 For City and related entities (HECFI, Library, BIA's Housing etc.). City only is $50,700.
The auditing standards require that we confirm our independence to the Audit Committee, or its equivalent in the context of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario. Accordingly, we hereby confirm that we are independent with respect to the City within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of November 25, 2005.

We look forward to discussing with you the matters addressed in this letter, as well as other matters that may of interest to you, at our upcoming meeting in February 2006. We will be prepared to answer any questions the Committee may have regarding our independence, as well as other matters.

This report is intended solely for use of the Strategic Planning and Budgets Committee and others within the City and should not be used for any other purposes.

Yours truly,

GRANT THORNTON LLP

Evan McDade, CA, CBV
Partner