Report to the Audit and Administration Committee – Initial Communication on Audit Planning

The City of Hamilton
For the year ended December 31, 2008
To the Members of the Audit and Administration Committee of
The City of Hamilton

We are pleased to enclose a copy of a document titled Report to the Audit and Administration Committee – Initial Communication on Audit Planning. This document covers the terms of our financial statement audit engagement of The City of Hamilton for the year ending December 31, 2008. It will help the committee understand the audit and non-audit services we provide to The City of Hamilton and the level of responsibility assumed by Grant Thornton LLP under Canadian generally accepted auditing standards.

If you have any particular comments, concerns or additional expectations that may require us to undertake additional work over and above that which is currently contemplated, please do not hesitate to raise them at our next scheduled meeting.

Yours sincerely,
Grant Thornton LLP

Allister Byrne, FCA
Partner
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The City of Hamilton – **Snapshot of the organization and recent changes**

The following is a summary of recent changes to the City’s operating environment, and relevant accounting and auditing standards. We have considered these factors in preparing the 2008 audit plan for The City of Hamilton.

**Organization-specific changes**

The City has been working on its compliance with PS 3150, *Tangible Capital Assets*, and has inventoried and valued several classes of its assets at December 31, 2008. For fiscal 2007, we audited the roads assets as at December 31, 2007. We will need to audit the changes in these assets in 2008. During 2008, we audited vehicles and land, and anticipate being able to audit other asset categories in early 2009 for inclusion in the 2008 financial statements.

As noted during the 2007 audit, the City holds third party sponsored and bank sponsored asset backed commercial paper (ABCP) with a cost of $97,038,000. Certain third party sponsors were unable to meet the funding requirements of maturing obligations and as a result an estimated loss was recognized in 2007. At the time of audit planning, no changes had occurred in the status of these investments. We will need to ensure the valuation at December 31, 2008 is appropriate based on current information.

**Accounting standards**

As in prior periods, there continues to be significant change with respect to accounting standards. Accounting standards issued by the CICA which may affect your business for the current and future years include:

<table>
<thead>
<tr>
<th>PSAB Section 3150 – Tangible Capital Assets</th>
<th>PSAB Section 2700 – Segment Disclosures</th>
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</thead>
<tbody>
<tr>
<td>Re-Exposure Draft – Government Transfers</td>
<td>PSAB Section 1200 – Financial Statement Presentation</td>
</tr>
<tr>
<td>Exposure Draft – Introduction to the Public Sector Accounting Standards</td>
<td>PSG – 7 – Tangible Capital Assets of Local Governments</td>
</tr>
</tbody>
</table>
Further detail of the changes to accounting standards, including preliminary comments on their applicability to The City of Hamilton, are included in Appendix A. If you have any questions about these changes we invite you to raise them during our next meeting. We will be pleased to address your concerns.
Achieving effective governance

There are several fundamental components of effective governance. The audit and administration committee plays a key role in achieving strong governance, particularly with respect to financial reporting.

### Roles in ensuring strong financial reporting

| Role of the Audit and Administration Committee | • Help set the tone for the organization by emphasizing honesty, ethical behaviour and fraud prevention  
• Oversee management, including ensuring that management establishes and maintains internal controls to provide reasonable assurance regarding reliability of financial reporting  
• Directly oversee the work of the external auditors including reviewing, discussing and approving audit plan |
| --- | --- |
| Role of Management | • Prepare financial statements in accordance with Canadian GAAP for public sector entities  
• Design, implement and maintain effective internal controls over financial reporting processes  
• Exercise sound judgment in selecting and applying critical accounting principles  
• Safeguard assets  
• Prevent, detect and correct errors  
• Provide representations to external auditors  
• Assess quantitative and qualitative impact of misstatements discovered during the audit on fair presentation of the financial statements |
| Role of Grant Thornton LLP | • Provide an audit opinion that the financial statements are in accordance with Canadian GAAP  
• Conduct our audit in accordance with Canadian GAAS  
• Maintain independence and objectivity  
• Be a resource to the audit committee and management  
• Communicate matters of interest to the audit and administration committee |
Quality assurance, independence and communication

Quality assurance
Grant Thornton LLP has a robust quality control program that forms a core part of our client service. We combine internationally developed audit methodology, advanced technology, rigorous review procedures, mandatory professional development requirements, and the use of specialists to deliver high quality audit services to our clients. In addition to our internal processes, we are subject to inspection and oversight by standard setting and regulatory bodies. We are proud of our firm’s approach to quality assurance and would be pleased to discuss any aspect with you at your convenience.

Independence
We have a rigorous process where we continually monitor and maintain our independence. The process of maintaining our independence includes, but is not limited to:

- Identification of threats to our independence and putting into place safeguards to mitigate those threats. For example, we evaluate the independence threat of any non-audit services provided to the City of Hamilton; and
- Confirming the independence of our engagement team members.

Communication with the audit committee
Communication is key to quality service. In conducting our audit we will communicate frequently with the audit committee so that issues and concerns are addressed in a timely and productive manner.

We encourage the members of the audit and administration committee to contact us at any time if questions or concerns arise.
Our audit approach

An understanding of your sector and your operations drives the Grant Thornton LLP audit approach. Tailoring is central to our approach and a key aspect in providing The City of Hamilton with quality service.

The objective of our audit is to obtain reasonable assurance that the financial statements are free of material misstatement. The responsibilities of the audit committee and management are broad and therefore the financial statement audit engagement is not designed to identify all matters which may be of interest to the audit committee or management in the discharge of these responsibilities. However, we will communicate the following should we encounter them during the course of our audit:
• Misstatements, other than trivial errors (more than 2% of planning materiality);
• Fraud;
• Misstatements that may cause future financial statements to be materially misstated;
• Illegal or possibly illegal acts, other than those considered inconsequential; and
• Material weaknesses and significant deficiencies in internal control over financial reporting.

**Internal control**

Our audit includes gaining an understanding of The City of Hamilton’s internal control over financial reporting. Our understanding will focus on processes associated with the identified financial statement risk areas (see below). The audit team uses this understanding to determine the nature, extent and timing of our audit procedures.

Our understanding may also result in valuable internal control findings for your consideration. Please note that the objectives of a financial statement audit are different from fiduciary control objectives. Therefore, management and the audit committee cannot rely on our findings to discharge their responsibilities in this area.

**Risk assessment**

Our risk assessment process has identified the following areas where we will focus our attention:

<table>
<thead>
<tr>
<th>Risk area</th>
<th>Planned audit procedures</th>
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<tbody>
<tr>
<td>Taxation</td>
<td>Test the existence of receivables at December 31, 2008 through subsequent receipt testing and other verification procedures. Recalculation of the net taxable assessment based on verified assessment roles and approved levies. Assess adequacy of allowance for doubtful accounts by testing subsequent receipts, reviewing management estimates and examining support for the value of underlying property.</td>
</tr>
<tr>
<td>Purchases and payables</td>
<td>Analytical assessment of expenses based on expectations. Review supporting documentation and management estimates with respect to the completeness and accuracy of significant year-end accruals.</td>
</tr>
<tr>
<td>Provisions for employee benefits</td>
<td>Review assumptions used by management. Test supporting documentation (ie actuarial valuations) relating to the various amounts and disclosures. Verify accuracy and reasonableness of amounts and disclosures, with reference to correspondence with lawyers, examination of supporting documentation, and discussions with management.</td>
</tr>
<tr>
<td>Commitments and contingencies</td>
<td></td>
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</tbody>
</table>

Given the significance of the tangible capital asset disclosures, we will also focus attention to this area. We have been auditing the processes and controls for inventorying and valuing various assets at January 1, 2008. We will audit 2008 additions, disposals and adjustments for these asset categories.

**Materiality**

The purpose of our audit is to provide an opinion as to whether your financial statements present fairly, in all material respects, the financial position, results of operations and cash flows in accordance with
generally accepted accounting principles as of December 31, 2008. Therefore, materiality is a critical auditing concept and as such we apply it in all stages of the engagement.

Applying the concept of materiality at the planning and execution stage of the engagement recognizes that the audit team cannot verify every balance, transaction or judgment made in the financial reporting process. During audit planning, we make a preliminary assessment of materiality for purposes of developing our audit strategy, including determining the extent of our audit procedures. During the completion stage, we consider not only the quantitative assessment of materiality, but also qualitative factors, in assessing the impact on the financial statements, our audit opinion and the matters reported to the audit committee.

We will communicate to the audit committee any differences noted throughout the audit greater than 2% of planning materiality.

**Fraud considerations**

We are responsible for planning and performing the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement caused by error or by fraud. Our audit procedures consider the requirements of CICA Handbook Section 5135, The Auditor’s Responsibility to Consider Fraud and Error. Section 5135 was issued to heighten the awareness of the potential for fraud when planning and executing audits and it emphasizes the need for professional skepticism during the audit.

The following provides a summary of some of the fraud-related procedures we plan to perform during the audit.

- Discuss amongst the engagement team where the financial statements may be susceptible to material misstatement due to fraud.
- Gather information to identify the risks of material misstatement due to fraud, including our understanding of internal control and making detailed inquiries to both management and members of the audit committee.
- Using the information gathered in our risk assessment process.

**Planned reliance on other auditors**

In forming our opinion on the consolidated financial statements of The City of Hamilton we plan to rely on the work of the following auditors:

<table>
<thead>
<tr>
<th>Entity</th>
<th>Relationship</th>
<th>Auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hamilton Utilities Corporation</td>
<td>Wholly-owned subsidiary</td>
<td>KPMG LLP</td>
</tr>
</tbody>
</table>
We will coordinate with these auditors the timing, area of audit focus and required information for our audit of the consolidated financial statements. Our risk assessment and quality control process may include reviewing their working papers and, if appropriate, performing supplemental audit procedures.

**Client assistance and readiness**

Client assistance and readiness are integral to the successful meeting of our targeted report release date. As presented further below, it is also critical in meeting our agreed fee. To facilitate the communication process, we have provided management with a letter detailing expected assistance and the critical milestone dates.

**Deliverables**

We are committed to executing our audit in a most effective, efficient and timely manner. We will provide the following deliverables to the audit and administration committee:

- Initial communication on audit planning,
- Audit report on the financial statements of The City of Hamilton,
- Communication of audit results, and
- Management letter that provides our observations and recommendations regarding internal controls, based on matters identified during the course of our audit.
Audit timetable

<table>
<thead>
<tr>
<th>Date</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>October and November 2008</td>
<td>Audit plans for local boards, including HECFI, Housing and Library Board etc.</td>
</tr>
<tr>
<td>December, 2008</td>
<td>Audit planning for the City of Hamilton.</td>
</tr>
<tr>
<td>December 31, 2008</td>
<td>Date for bank confirmations to be signed. We also require a cutoff report of the taxes receivable subledger and all inventory listings as at December 31, 2008.</td>
</tr>
<tr>
<td>February 2009</td>
<td>Meeting with Audit and Administration Committee and presentation of Report to the Audit and Administration Committee – Initial Communication on Audit Planning</td>
</tr>
<tr>
<td>March 30 – April 24, 2009</td>
<td>Year-end visit</td>
</tr>
<tr>
<td>May 2009</td>
<td>Preliminary clearance to be provided on draft consolidated financial statements</td>
</tr>
<tr>
<td>May 20, 2009</td>
<td>Meeting with the Audit and Administration Committee and presentation of Report to the Audit and Administration Committee – Communication of Audit Results</td>
</tr>
</tbody>
</table>
Fee schedule

Fee proposal considerations
Upfront and periodic discussions are central to our approach in dealing with fees. Our goal is to avoid surprises by having early and frank communication. We wish to provide The City of Hamilton with a competitive price and fair value, while also allowing sufficient audit hours to conduct an effective audit and deliver quality service.

We have established a proposed fee for the audit for the years ended 2006 to 2010 that is based on the level of activity and the anticipated complexity of the audit of The City of Hamilton financial statements.

The proposed fee is based on receiving the following from management:

- Draft financial statements including the notes to the financial statements;
- All working papers and schedules as outlined in our requirements letter;
- Relevant FIR schedules to support the financial statements;
- All books and records made available to us when requested; and
- Use of the City’s’ staff to help us locate information and provide explanations.

Our ability to deliver the services outlined in the agreed timetable and our proposed fee will depend upon these schedules being available/tasks being completed by the due dates. If there are any variances to the above plan, we will discuss them with you and agree to any additional fees before costs are incurred, wherever possible.

Any unforeseen work outside the scope of this proposal will be billed separately after discussion with appropriate City management. For the additional tangible capital assets work, we have provided an estimated fee range to management for various classes of assets.
Appendix A – Accounting developments

<table>
<thead>
<tr>
<th>Public Sector Accounting Board</th>
<th>Effective date</th>
<th>Assessment of Applicability</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSAB Section 3150 - Tangible Capital Assets</td>
<td>The revised Section applies to local governments for fiscal years beginning on or after January 1, 2009.</td>
<td>Implementation is required in fiscal 2009. Status of implementation will be included in the notes to the financial statements this year.</td>
</tr>
</tbody>
</table>

PSAB has approved revisions to Section PS 3150 “Tangible Capital Assets.” The Section now applies to all levels of government, including local governments. The most prominent change for local governments is the requirement to recognize and amortize all their tangible capital assets.

Revisions to the Section include:
- The definition of cost has been amended to clarify that cost is the gross amount, and that capital grants are not to be netted against the cost of the related tangible capital asset. Guidance on the cost of leased tangible capital assets is also provided.
- The 40-year guideline on the amortization period has been removed.
- There is additional guidance on the commencement and cessation of capitalizing carrying costs.
- During the period of transition, local governments should follow Public Sector Guideline PSG-7, Tangible Capital Assets of Local Government.
### Public Sector Accounting Board

#### PSAB Section 1200 – Financial Statement Presentation
This Section has been revised as a result of the CICA Public Sector Accounting Handbook requirement to adopt the full accrual basis of accounting for local governments.

This Section establishes standards for recognition, presentation and disclosure in government financial statements. The main features of the Section are as follows:

- Governments are required to present a statement of financial position, statement of operations, statement of changes in net debt and a statement of cash flows
- Financial statements should present net debt and accumulated surplus/deficit on the statement of financial position, annual surplus/deficit, the change in net debt and changes in cash flows
- Current year budget and actual figures are to be presented on both the statement of operations and the statement of changes in net debt
- Funds and reserves are to be reported in the notes or schedules when the government chooses to report on them

This Section currently applies to senior levels of government.

This Section will apply to local governments for fiscal years beginning on or after January 1, 2009.

Earlier adoption is encouraged.

#### PSAB Section 2700 - Segment Disclosures
This Section establishes standards on how to define, identify and disclose segments in a government’s summary financial statements. In providing segment disclosures, it is important that the definition of a segment is met, the objectives for segment disclosures are satisfied and an appropriate basis of segmentation is chosen.

The Section specifies both the required and desired segment disclosures in a government’s financial statements. As a minimum, the notes or schedules to the financial statements for each government segment must include:

- The basis for identifying segments, the nature of the segments, the activities they encompass and the method of significant allocations to segments
- Segment expense by major object or category
- Segment revenue by source and type
- Aggregate net surplus/deficit of government business enterprises and government business partnerships accounted for under the modified equity method for each segment, if applicable
- Aggregate net surplus/deficit of government organizations accounted for under the modified equity basis in accordance with PSA 1300.47, if applicable; and
- A reconciliation between the information disclosed for the segments and the consolidated information in the summary financial statements

The standard applies to the summary financial statements of federal, provincial, territorial and local governments for fiscal years beginning on or after April 1, 2007.

Earlier adoption is encouraged.
PSG-7 – Tangible Capital Assets of Local Governments
This Guideline provides transitional guidance to local governments on presenting information related to tangible capital assets in notes or schedules to its financial statements until such time as Tangible Capital Assets, Section PS 3150 is adopted by local governments. PS 3150 applies to local governments for fiscal years beginning on or after January 1, 2009, although earlier adoption is encouraged.

Re-Exposure Draft - Government Transfers
PSAB issued a Re-Exposure draft, “Government Transfers” proposing to amend the current Public Sector Accounting Handbook Section, PS 3410 Government Transfers.

In general, the proposed standard:
- Defines government transfers
- Details when government transfers should be recognized as revenue or expenses
- Describes when a recipient government would recognize a liability for a transfer
- Provides guidance on determining the authorization date of the transfer, and
- Addresses multi-year operating transfers provided and received, capital transfers received, the point of authorization, and the volatility of results.

Exposure Draft – Introduction to the Public Sector Accounting Standards
The Exposure Draft proposes to amend the current “Introduction to the Public Sector Accounting Standards.” The objective is to clarify which GAAP government organizations should apply when preparing their own financial statements.

PSAB intends to consider the implications of the AcSB strategies on government organizations in two phases.

This Exposure Draft represents the first phase addressing government business enterprises and government business-type organizations. The proposals state that when preparing financial statements for their own purposes, government business enterprises and government business-type organizations should follow the CICA Handbook – Accounting for publicly accountable enterprises.

The second phase will examine government not-for-profit organizations and other government organizations that may currently apply CICA Handbook – Accounting.