City of Hamilton

Report to the Strategic Planning and Budgets Committee

May 17, 2006
May 17, 2006

To the Members of the Strategic Planning and Budgets Committee of the City of Hamilton

The audit work of the consolidated financial statements of the City of Hamilton for the year ended December 31, 2005 is complete.

This report has been prepared in accordance with the assurance recommendations issued by the Canadian Institute of Chartered Accountant (CICA) entitled “Communications with Those Having Oversight Responsibility”. That standard recommends we communicate certain matters regarding our responsibility as auditors, management’s responsibilities, significant accounting policies and other matters that should be of interest to the oversight body. In the City of Hamilton’s existing Committee structure, responsibility for financial reporting has been assigned to the Strategic Planning and Budgets Committee.

We express our appreciation for the cooperation and assistance received from the management of the City of Hamilton during the course of our audit.

We will respond to any questions relating to this report or on any other matters of interest to the Committee during our meeting.

Yours truly,

GRANT THORNTON LLP

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Introduction

This report is prepared in order to assist the members of the Strategic Planning and Budgets Committee ("the Committee") in carrying out their responsibilities with respect to the review of, and recommendation to Council for approval, the financial statements of the City of Hamilton for the year ended December 31, 2005.

This report summarizes those significant matters that we believe should be brought to your attention. We emphasize that the audit and this report would not necessarily identify all matters that may be of interest to the Committee.

Please note that this report has been prepared solely for the purpose of assisting the Committee in the discharge of its responsibility and should not be used for any other purpose. We disclaim any obligation to any other party that may rely upon this report.
Audit Scope and Responsibility

Auditors’ report
We have completed our audit of the financial statements of the City of Hamilton for the year ended December 31, 2005. Our Auditors’ Report, dated April 28, 2006 is without reservation.

Our audit of the financial statements has been performed in accordance with Canadian generally accepted auditing standards, and was performed to obtain reasonable, rather than absolute, assurance whether the financial statements are free of material misstatement.

Our audit included:
- assessing the risk that the financial statements may contain material misstatements
- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements
- assessing the accounting principles used and their application
- assessing the significant estimates made by management.

Our audit procedures were limited to those that Grant Thornton considered necessary in the circumstances. Such tests would not necessarily detect fraud, irregularities and error even if material in amount.

Audit Plan
The audit was planned based on the gathering of evidence through review of documents and interviews of management. At the planning stage of the audit, we identified that certain transaction cycles posed a higher degree of risk for potential misstatement in the financial statements. For the City, the cycles of higher risk were identified as including: taxation; water and sewer revenues; social and public health services; purchases and payables; provisions for employment benefits and landfill closure; commitments and contingencies.

For purposes of the audit, Grant Thornton obtains a sufficient understanding of the accounting systems and the system of internal control. Those controls, which we identify as key, are tested as part of our audit work, and the results of the testing may permit us to rely
on the controls. However, the audit is not designed to allow an opinion on the system of internal control.

Grant Thornton’s 2005 audit plan was presented and approved by the Strategic Planning and Budgets Committee at its meeting of February 8, 2006.

Reliance on Other Professionals
Grant Thornton was required to place reliance on other professionals for purposes of gathering audit evidence and expressing an opinion on the financial statements for the City. The auditors for the consolidated financial statements of Hamilton Utilities Corporation are another firm of auditors. We are required to rely on the conduct of their audit to gain assurance over the amounts recorded in the City’s financial statements related to the Hamilton Utilities Corporation. Also, the City has relied on the work of an actuary for the determination of liabilities associated with employee benefits, including pensions.

Independence
As external auditors of the City, we are required to be independent in accordance with the Canadian professional requirements. These standards require that we disclose to the Committee all relationships that, in our professional judgement, may reasonably be thought to bear on independence. We have addressed a letter to the Strategic Planning and Budgets Committee, presented in Appendix B to this report, which confirms that we are objective with respect to the City of Hamilton within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of May 17, 2006.

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 financial statements.

Other Services
Included in the letter in Appendix B is an outline of other services which we provided to the City and related entities during the year.
Responsibility of Management

**Preparation of financial statements**

The preparation of the financial statements, including the accompanying notes, is the responsibility of management. This includes the preparation of the financial statements in accordance with Canadian generally accepted accounting principles.

Management is responsible for selecting the significant accounting policies used in the preparation of the financial statements, and for applying judgement in preparing accounting estimates contained in the financial statements, as well as for preparing or obtaining documentation supporting amounts and disclosures in the financial statements. In addition, management is responsible for assessing the impact of any misstatements detected during the preparation and audit of the financial statements, individually and in aggregate, on the fair presentation of amounts and disclosures contained in the financial statements and determining if such adjustments should be recorded.

Additionally, it is management’s responsibility to ensure that all financial records and related information are provided to the auditors. Management and Council are responsible for ensuring that the corporation has an internal control structure adequate to permit the preparation of accurate financial statements in accordance with generally accepted accounting principles.

**Management’s representations**

The transactions and estimates reflected in the accounts and in the financial statements are within the direct control of management. Accordingly, the fairness of the representations made through the financial statements is an implicit and integral part of management’s responsibility.

Throughout the course of our audit, we obtain representations from management in the form of answers to our audit enquiries. We also obtain a formal representation letter from management at the conclusion of the audit.
Significant Matters to be Reported

The Canadian Institute of Chartered Accountants has specified matters that should be brought to the attention of the oversight body. The following summarizes the matters to be communicated.

**Significant accounting principles and policies**
Significant accounting principles and policies are disclosed in the notes to the financial statements. Within the context of the audit, management has represented to us that there have not been any material changes in the accounting principles and policies during the year. The housing entities are consolidated consistent with the controlling ability of the City.

We have not noted any significant unusual transactions.

**Management’s judgements and accounting estimates**
Management has the responsibility for applying judgement in preparing the accounting estimates and disclosures contained within the financial statements. The fact that estimates are used in the preparation of the financial statements is outlined in Note 1(j) to the financial statements. The following are particularly sensitive estimates and disclosures included within the financial statements:

1. Liabilities for employee benefits
2. Pension benefits
3. Liabilities for solid waste landfill sites
4. Allowance for doubtful accounts
5. Contingent liabilities and public liability claims.

**Liability for employee benefits:**
The City has recognized liabilities of over $201.6 million in employee benefits. As disclosed in Note 9 of the financial statements, the employee benefits include vested sick leave, workers safety and insurance, long term disability, vacation pay, retirement and pensions.
The objective of the accounting policy is to recognize a liability in the reporting period in which employees have provided the services that gives rise to the benefits. The amounts recorded by the City are determined based on actual entitlements less usage and an actuarial valuation for post employment benefits that projected medical costs increasing initially at 7.5% per year, reducing by .5% annually to 4.5% by 2011, dental costs increasing at a rate of 4.5% per year, discounted utilizing a discount rate of 6.0%.

Of the total $201.6 million (2004 - $199.3 million), an amount of $46.3 million (2004 - $42 million) has been provided in reserves, $188.9 million identified as liabilities to be recovered in future (2004 - $187.2 million), and $12.7 million (2004 - $12.1 million) accounted for as a liability as at December 31, 2005.

Pension benefits:
The City provides defined pension plans for its employees through the Ontario Municipal Employees Retirement System and three plans administered by the City for specific employees. Note 10 to the financial statements outlines the assumptions that were provided by management to the actuary for purposes of determining the benefit obligation. Assumptions included the annual rate of compensation increase, inflation rate, and discount rate.

The actuarial valuation for each of the plans is an extrapolation to December 31, 2005 of the previous actuarial valuations based on new assumptions. Payments during the year of approximately $4.8 million contributed toward reducing the amount of the actuarially determined deficit in the HWRF plan. The City will be funding this deficit of $59.2 million over the next 9 to 11 years.

Liabilities for solid waste landfill sites:
Accounting recommendations require that the costs for closure and post-closure costs relating to the City’s landfill sites (both closed and open) be recognized as a liability. As disclosed in Note 11, the liability of $38.6 million (2004 - $39.9 million) has been determined after estimating current and future cash flows associated with the 13 landfill sites, assuming an inflation rate of 3.0% and utilizing a discount rate of 6.0%. The liabilities also utilize assumptions regarding waste diversion targets.

Allowance for doubtful accounts:
Included in the taxes receivable balance of $58.7 million on the Consolidated Statement of Financial Position are provisions of $4.9 million (2004 - $7.7 million), representing management’s estimate of uncollectible taxes and write-offs relating to outstanding balances. Included in the accounts receivable balance of $76.3 million (2004 - $84.0 million) on the Consolidated Statement of Financial Position are provisions for uncollectible amounts of $0.6 million (2004 - $1.8 million).
Contingent liabilities and public liability claims:
Amounts provided for in the financial statements relating to public liability claims (self-insured portion) are disclosed in Note 22, and include liabilities and accruals of $20.5 million (2004 - $16.5 million) and reserves of $0.1 million (2004 - $0.1 million). As disclosed in Note 23, the outcomes and potential liability relating to other legal actions against the City are not determinable, and accordingly no amounts have been accrued in the financial statements.

Materiality
Grant Thornton planned the audit with the objective of having reasonable assurance of detecting misstatements that would be material to the financial statements taken as a whole. As required by audit standards, materiality was utilized during the conduct of the audit and the evaluation of any misstatements identified.

Audit differences and significant audit adjustments
Audit differences represent findings for which we do not agree with the amount, classification, presentation or disclosure of items in the financial statements. As auditors, we are required to consider the cause of any differences and communicate our findings to the oversight body.

In conducting our procedures, we identified two differences that required adjustments to the recorded amounts. This included:

1. Provision for loans with concessionary terms was understated by $375,000. An amount was included in reserves for potential increases required in the provision in 2006. These were adjusted from reserves into current year operations.

2. Amortization of the investment premium/discount was overstated $365,000 and interest income receivable was understated by $325,000. The net impact on the net municipal position was only $40,000. An additional amount of investment interest receivable of $292,500 was recorded on the Hamilton Future Fund.

These audit items were discussed with management, who determine if an adjustment should be recorded. All audit differences identified which related to the City’s municipal position as at December 31st, 2005 were discussed with management and adjusted. See Appendix C for a summary of differences noted during the audit.
Internal controls
The responsibility for the design and operation of an effective system of internal controls which provides reasonable assurance that the accounting systems provide timely, accurate and reliable financial information, as well as safeguard the assets of the City, is the day to day responsibility of management.

As mentioned earlier, for purposes of the audit, Grant Thornton obtains a sufficient understanding of the accounting systems and the system of internal control. Those controls identified as key are tested as part of our audit work however the audit is not designed to allow an opinion on the system of internal control.

As a result of the audit testing, we did detect issues for the Committee’s attention. Subject to receiving managements response(s) on items noted, communication regarding financial management matters, internal controls and accounting will be reported to the Committee in our Letter of Recommendations.

Illegal acts
Our inquiries of management and our testing of financial records did not reveal any illegal or possible illegal acts. However, please be aware that improper conduct is usually carefully and often elaborately concealed and therefore, the probability of detecting such is not high. Management is also asked in the formal letter of representations to disclose if they are aware of any illegal or possible illegal acts.

Related party transactions
Transactions with related parties disclosed are those with Hamilton Utilities Corporation and Hamilton Renewable Power Inc. Note 4 to the financial statements outlines the nature of the relationship and the corresponding transactions and balances.

Consultation with other accountants
To our knowledge, management discussed no accounting or auditing matters with other accountants.

Cooperation during the Audit
We report that we have received cooperation from management and employees of City of Hamilton. We appreciate their diligent efforts in preparing required working papers and audit requirements, responding to our queries, and minimizing and promptly communicating all scheduling delays.

To our knowledge, we were provided access to all necessary accounting records and other documentation that we needed in order to carry out our audit. Issues identified as a result of the audit work, whether in amounts for the financial statements or disclosure, were
discussed with management and issues have been resolved to our satisfaction. There were no limitations placed on the scope of the auditors.

Other matters
We are not aware of any other matters that require the attention of the Committee or Council before they approve the financial statements.
Current Accounting and Reporting Developments

We continually monitor the potential impact of new accounting pronouncements on the accounting practices of the City. An overview of current assurance and financial reporting developments was included in our audit planning communication, presented to the Strategic Planning and Budgets Committee at its meeting of February 8, 2006.

**Amendment to Tangible Capital Assets – PS 3150**

In March 2006, the Public Sector Accounting Board released an exposure draft of CICA Public Sector Accounting (“PSA”) Handbook Section, PS 3150 Tangible Capital Assets, (exposure draft). The final PSA Handbook Section is expected to be approved in June 2006.

The revised Section updates the standards on how to account for and report tangible capital assets in government financial statements. The standard is intended to apply to all levels of government, including local governments, their boards and commissions; such as libraries, airports and transit, who are excluded from the current standard.

**Change in basis of accounting for local governments**

Currently, local government accounting standards are based on a modified accrual method of accounting for non-financial assets which do not require capital expenditures to be recognized as an asset and amortized over their expected useful lives. There are many benefits associated with having all levels of government using the same basis of accounting which is one of the driving factors for this change.

Local governments do not currently have a generally accepted definition of a tangible capital asset. Items included in tangible capital assets vary from province to province and among local governments within the same province. As a result of this standard, all government tangible capital assets, such as roads, buildings, vehicles, equipment, land, water, sewer and other utility systems, aircraft, computer hardware and bridges would be recorded in a government’s accounting system and reported on the statement of financial position as a non-financial asset.
The transitional requirements of this standard require a historical cost to be recorded at initial adoption. When historical cost information is not available other methods to estimate the cost and accumulated amortization will need to be used. These methods should be applied on a consistent basis unless it can be demonstrated that a more accurate estimate is appropriate for a particular type of tangible capital asset.

Adequately preparing for the change is critical, the determination of a historical cost on existing assets and maintaining the cost on future tangible capital assets as required by PS 3150 may require dedicated and significant resources. If the City is not prepared in time for the adoption of PS 3150, they may be subject to a qualified auditors’ report for non-compliance with Generally Accepted Accounting Principles.

Timing
The revised Section is expected to apply to local governments for fiscal years beginning on or after January 1, 2009, although earlier adoption is encouraged.
Summary

We thank management and the staff for the cooperation and assistance provided to us during the audit. We continue to enjoy our business relationship with the City of Hamilton and we look forward to future years of service.
Appendix A

Auditor’s Report

To the Members of Council, Inhabitants and Ratepayers of the City of Hamilton

We have audited the consolidated statement of financial position of the City of Hamilton as at December 31, 2005 and the consolidated statements of financial activities and changes in financial position for the year then ended. These consolidated financial statements are the responsibility of the City’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the City as at December 31, 2005 and the results of its operations for the year then ended in accordance with Canadian generally accepted accounting principles.

Budget figures are provided for comparative purposes and have not been subject to audit procedures. Accordingly, we do not express any opinion regarding the budget figures.

Hamilton, Ontario
April 28, 2006
Chartered Accountants

DRAFT
Independence Letter
April 28, 2006

City of Hamilton
71 Main Street West
Hamilton, Ontario
L8P 4Y5

Dear Strategic Planning and Budgets 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 require that we communicate at least annually with you regarding all relationships between the City and Grant Thornton LLP that, in our professional judgement, may reasonably be thought to bear on our independence.

In determining which relationships to report, these standards require us to consider relevant rules and related interpretations prescribed by the appropriate provincial institute and applicable legislation, 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 have prepared the following comments to facilitate our discussions with you regarding independence matters arising since November 25, 2005, the date of our last letter.
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 November 25, 2005 to April 28, 2006 were as follows:

<table>
<thead>
<tr>
<th>Services</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Audit Services</td>
<td>$53,500</td>
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We are not aware of any relationships between the City and ourselves that in our professional judgment may reasonably be thought to bear on our independence.

Generally accepted auditing standards require that we confirm our independence to the Strategic Planning and Budgets Committee (financial reporting oversight body). However, since the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario deal with the concept of independence in terms of objectivity, our confirmation is to be made in that context. Accordingly, we hereby confirm that we are objective with respect to the City within the meaning of the rules of professional conduct of the Institute of Chartered Accountants of Ontario as at April 28, 2006.

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

We look forward to discussing with you the matters addressed in this letter as well as other matters that may be of interest to you.

Yours truly

GRANT THORNTON LLP

Evan McDade, CA, CBV
Partner

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1 For City and related entities (HECFI, Library, BIA’s, Housing etc). City only is $18,000.
Appendix C

Summary of Audit Differences
### CITY OF HAMILTON

#### SUMMARY OF AUDIT DIFFERENCES

<table>
<thead>
<tr>
<th>CYCLE</th>
<th>ASSETS</th>
<th>LIABILITIES</th>
<th>REVENUE</th>
<th>EXPENDITURE</th>
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<td>AUDIT DIFFERENCES IDENTIFIED RE: 2005 ENDING FINANCIAL POSITION</td>
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<tr>
<td>1 Understatement of Provision for loans with concessionary terms.</td>
<td>OTHER ASSETS</td>
<td>(375,000)</td>
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<td>(375,000)</td>
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<tr>
<td>2 Adjustment for amortization of Windsor Trust investment investments.</td>
<td>INVESTMENTS</td>
<td>(365,000)</td>
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<td>(365,000)</td>
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<td>3 Adjustment for interest income receivable on investments</td>
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<td>617,500</td>
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<td>617,500</td>
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<td>4 Reclassification of amounts on statement of financial. position</td>
<td></td>
<td></td>
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<td></td>
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<td>(1,300,000)</td>
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<td></td>
<td>(1,422,500)</td>
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<td>(122,500)</td>
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<td>LESS: ADJUSTMENTS SUBSEQUENTLY BOOKED BY MANAGEMENT</td>
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<td>UNADJUSTED ITEMS</td>
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