Report to the Audit & Administration Committee - Communication of Audit Results

Corporation of the City of Hamilton

Trust Funds of the City of Hamilton

Trust Funds - Homes for the Aged, City of Hamilton

Pension Fund for The Hamilton Municipal Retirement Fund Pension Plan

Pension Fund for The Hamilton Wentworth Retirement Fund Pension Plan

Pension Fund for the Employees of The Hamilton Street Railway Company Pension Plan

For the year ended December 31, 2006
May 7, 2007

To the members of the Audit and Administration Committee of
The City of Hamilton

We are pleased to report that we have now substantially completed our audits of the financial statements of the Corporation of the City of Hamilton, the Trust Funds of the City of Hamilton, the Trust Funds – Homes for the Aged, City of Hamilton, and the Pension Funds for The Hamilton Municipal Retirement Fund Pension Plan (HMRF), The Hamilton Wentworth Retirement Fund Pension Plan (HWRF) and the Employees of The Hamilton Street Railway Company Pension Plan (HSR) for the year ended December 31, 2006. We have attached our draft auditors’ report for the City of Hamilton as an example. We will finalize these auditors’ reports once we have the opportunity to discuss the results of our audits with you.

The report to the Audit and Administration Committee has been prepared in accordance with the assurance recommendations issued by the Canadian Institute of Chartered Accountants (CICA) entitled “Communications with Those Having Oversight Responsibility for the Financial Reporting Process”. That standard recommends we communicate with the Board various matters including: the overall audit strategy, our responsibility as auditors, any matters arising from the audit, misstatements, significant accounting policies, and any other matters that may be of interest to the Audit and Administration Committee.

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

If you have any particular comments or concerns, please do not hesitate to raise them at our scheduled meeting.

Yours very truly,
GRANT THORNTON LLP

Evan McDade, CA, CBV
Partner
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Status of the audit

We have substantially completed our audits of the financial statements of the Corporation of the City of Hamilton, the Trust Funds of the City of Hamilton, the Trust Funds – Homes for the Aged, City of Hamilton, and the Pension Funds for The Hamilton Municipal Retirement Fund Pension Plan (HMRF), The Hamilton Wentworth Retirement Fund Pension Plan (HWRF) and the Employees of The Hamilton Street Railway Company Pension Plan (HSR) for the year ended December 31, 2006 and the results of those audits are included in this report.

As noted in the covering letter, we have attached our draft auditors’ report for the City of Hamilton as Appendix A. The following items need to be addressed/completed before that report is signed:

- Receipt of signed management representation letters (draft has been attached as Appendix B);
- Receipt of the response to our legal enquiries;
- Completion of the audit of Hamilton Renewable Power Inc.; and
- Approval of the financial statements by the Audit and Administration Committee.
Audit results

Our audit of the City of Hamilton did not identify any non-trivial differences.

There were no differences identified in the financial statements of the Trust Funds – Homes for the Aged, City of Hamilton, and the Pension Funds for The Hamilton Municipal Retirement Fund Pension Plan (HMRF), The Hamilton Wentworth Retirement Fund Pension Plan (HWRF) and the Employees of The Hamilton Street Railway Company Pension Plan (HSR).
Reportable matters

Internal control
Management is responsible for the design and operation of an effective system of internal control that provides reasonable assurance that the accounting system provides timely, accurate and reliable financial information, and safeguards the assets of the entity.

Through our role as auditors of your financial statements we possess an understanding of the entity and its environment, including internal control. However, a financial statement audit is not designed to provide assurance on internal control. Professional standards do require us to communicate to the Audit and Administration Committee material weaknesses and significant deficiencies in internal control that have come to our attention in the course of performing the audit.

During the course of performing our audit, we identified opportunities for enhancement of IT controls. Our comments and recommendation on these matters have been provided in an internal control letter.

Significant new accounting policies
There were no significant new accounting policies noted in the year.

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 $198.4 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 6.5% 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 $198.4 million (2005 - $201.6 million), an amount of $50.6 million (2005 - $46.3 million) has been provided in reserves, $185.2 million identified as liabilities to be recovered in future (2005 - $188.9 million), and $13.2 million (2005 - $12.7 million) accounted for as a liability as at December 31, 2006.

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, 2006 of the previous actuarial valuations based on new assumptions. Payments during the year of approximately $5.7 million contributed toward reducing the amount of the actuarially determined deficit in the HWRF plan. The City will be funding this deficit of $53.4 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 $37.0 million (2005 - $38.6 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 5.0%. The liabilities also utilize assumptions that include the City of Hamilton achieving a 65% diversion rate by the year 2008.

Allowance for doubtful accounts:

Included in the taxes receivable balance of $54.0 million on the Consolidated Statement of Financial Position are provisions of $3.5 million (2005 - $4.9 million), representing management’s estimate of uncollectible taxes and write-offs relating to outstanding balances. Included in the accounts receivable balance of $68.4 million (2005 - $76.8 million) on the Consolidated Statement of Financial
Position are provisions for uncollectible amounts of $0.3 million (2005 - $0.6 million). Amounts remaining uncollected for more than 120 days at December 31, 2006 total approximately $1.2 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 $20.1 million (2005 - $20.5 million) and reserves of $0.2 million (2005 - $0.2 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.

Controversial, emerging or unique accounting policy issues
There were no new controversial, emerging or unique accounting policies issues noted.

Cooperation during the audit
We report that we received cooperation from the employees of the City of Hamilton. To our knowledge, we were provided access to all necessary records and other documentation and any issues that arose as a result of our audit were discussed with staff and have been resolved to our satisfaction.

Consultations with other accountants
To our knowledge, management did not seek the advice or opinion of other external accountants on financial reporting or accounting matters.

Fraud and illegal acts
Our inquiries of management did not reveal any fraud or illegal acts.

Independence
As external auditors of the Corporation of the City of Hamilton, we are required to be independent in accordance with Canadian professional standards. These standards require that we disclose to the Audit Committee all relationships that, in our professional judgement, may reasonably be thought to bear on our independence. We have provided a letter to the Board, presented as Appendix C of this report which confirms our independence with respect to the Corporation of the City of Hamilton.
Technical updates

Accounting and auditing standards
Recent changes in accounting and auditing standards have been summarized in Appendix D. These accounting and auditing changes have had no effect on financial reporting for the Corporation of the City of Hamilton in 2006.
Appendix A – Draft auditors’ reports

DRAFT

Auditors' Report

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

We have audited the consolidated statement of financial position of the Corporation of the City of Hamilton as at December 31, 2006 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 financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation of the City of Hamilton as at December 31, 2006 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 Grant Thornton LLP
April 27, 2007 Chartered Accountants
Licensed Public Accountants
Appendix B – Draft Management Representation Letter
(sample of the City of Hamilton letter only)

April 27, 2007

Grant Thornton LLP
Standard Life Centre
120 King Street West
Suite 1040
Hamilton, Ontario
L8P 4V2

Dear Sir/Madam:

We are providing this letter in connection with your audit of the financial statements of the Corporation of the City of Hamilton as of December 31, 2006 and for the year then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, financial activities, and changes in financial position of the Corporation of the City of Hamilton in accordance with Canadian generally accepted accounting principles.

We acknowledge that we are responsible for the fair presentation of the financial statements in accordance with Canadian generally accepted accounting principles and for the design and implementation of internal controls to prevent and detect fraud and error. We have assessed the risk that the financial statements may be materially misstated as a result of fraud, and have determined such risk to be low. Further, we acknowledge that your examination was planned and conducted in accordance with Canadian generally accepted auditing standards so as to enable you to express an opinion on the financial statements. We understand that while your work includes an examination of the accounting system, internal controls and related data to the extent you considered necessary in the circumstances, it is not designed to identify, nor can it necessarily be expected to disclose, fraud, shortages, errors and other irregularities, should any exist.

Certain representations in this letter are described as being limited to matters that are material. An item is considered material, regardless of its monetary value, if it is probable that its omission from
or misstatement in the financial statements would influence the decision of a reasonable person relying on the financial statements.

We confirm, to the best of our knowledge and belief, as of April 27, 2007, the following representations made to you during your audit.

**Financial statements**

1. The financial statements referred to above present fairly, in all material respects, the financial position of the entity as at December 31, 2006 and the results of its financial activities, and changes in financial position for the year then ended in accordance with Canadian generally accepted accounting principles.

**Completeness of information**

2. We have made available to you all financial records and related data and all minutes of the meetings of shareholders, directors, and committees of directors. Summaries of actions of recent meetings for which minutes have not yet been prepared have been provided to you. All significant board and committee actions are included in the summaries.

3. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

4. We are unaware of any known or probable instances of non-compliance with the requirements of regulatory or governmental authorities, including their financial reporting requirements.

5. We are unaware of any violations or possible violations of laws or regulations the effects of which should be considered for disclosure in the financial statements or as the basis of recording a contingent loss.

6. We have identified to you all known related parties and related party transactions, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements guarantees, non-monetary transactions and transactions for no consideration.

**Fraud and error**

7. We have no knowledge of fraud or suspected fraud affecting the entity involving management; employees who have significant roles in internal control; or others, where the fraud could have a non-trivial effect on the financial statements.

8. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity’s financial statements communicated by employees, former employees, analysts, regulators or others.

**Recognition, measurement and disclosure**

9. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
10. All related party transactions have been appropriately measured and disclosed in the financial statements.

11. We have informed you of all outstanding and possible claims, whether or not they have been discussed with legal counsel.

12. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.

13. With respect to environmental matters:
   (a) at year end, there were no liabilities or contingencies that have not already been disclosed to you;
   (b) liabilities or contingencies have been recognized, measured and disclosed, as appropriate, in the financial statements; and
   (c) commitments have been measured and disclosed, as appropriate, in the financial statements.

14. The entity has satisfactory title to (or lease interest in) all assets, and there are no liens or encumbrances on the entity’s assets nor has any been pledged as collateral.

15. We have disclosed to you, and the entity has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

16. The Goods and Services Tax (GST) transactions recorded by the entity are in accordance with the federal and provincial regulations. The GST receivable amounts recorded by the entity are considered complete.

17. There have been no events subsequent to the balance sheet date up to the date hereof that would require recognition or disclosure in the financial statements. Further, there have been no events subsequent to the date of the comparative financial statements that would require adjustment of those financial statements and related notes.

Other

18. The entity has obtained all consents and authorizations under law in respect of the personal information, if any, of employees, customers and other individuals provided to you in the course of your audit, and you are authorized to use such personal information required for your workpapers.

(City Manager) & (General Manager, Finance and Corporate Services)
Appendix C – Letter of Independence

May 7, 2007

Audit and Administration Committee
Corporation of the City of Hamilton

Dear Members of the Audit and Administration Committee:

We have been engaged to audit the financial statements of the Corporation of the City of Hamilton, the Trust Funds of the City of Hamilton, the Trust Funds – Homes for the Aged, City of Hamilton, and the Pension Funds for The Hamilton Municipal Retirement Fund Pension Plan (HMRF), The Hamilton Wentworth Retirement Fund Pension Plan (HWRF) and the Employees of The Hamilton Street Railway Company Pension Plan (HSR) for the year ending December 31, 2006.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the organization 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 give 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 organization and ourselves that in our professional judgement may reasonably be thought to bear on our independence that, have occurred from December 13, 2006, the date of our last letter, to May 7, 2007.
There were no non-audit services provided to the City of Hamilton during this period. Invoices issued during this period for audit services\(^1\) were $160,300.

GAAS requires that we confirm our independence to the Audit and Administration Committee. 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 organization within the meaning of the rules of professional conduct of the Institute of Chartered Accountants of Ontario as of May 7, 2007.

This report is intended solely for the use of the Audit and Administration Committee, management and others within the organization 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 very truly,

GRANT THORNTON LLP

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\(^1\) For City and related entities (HECFI, Library, BIAs, Housing, Gas tax etc). City audit only is $75,000.
The planning memorandum provided December 13, 2006 (presented to the committee on February 7, 2007) included accounting and auditing developments through that date.

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<thead>
<tr>
<th>Accounting – Standards issued by the CICA</th>
<th>Effective date</th>
<th>Assessment of applicability</th>
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<tr>
<td><strong>PS 3150 – Tangible Capital Assets</strong></td>
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<td>PSAB has approved revisions to Section PS 3150, Tangible Capital Assets, focused primarily on local governments recognizing and amortizing all their tangible capital assets.</td>
<td>This Section is effective for fiscal years beginning on or after January 1, 2009, with earlier adoption encouraged.</td>
<td>No impact on reporting for 2006.</td>
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<td>Additional revisions to Section PS 3150, which affect all governments, include:</td>
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<td>• clarifying the definition of &quot;cost&quot; to stop netting capital grants against tangible;</td>
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<td>• additional guidance on when to start and stop capitalizing carrying costs;</td>
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<td>• removing the 40 year amortization cap; and</td>
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<td>• moving tangible capital asset disclosure requirements in Section PS1200, Financial Statement Presentation – Federal, Provincial &amp; Territorial Governments, to Section PS 3150.</td>
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<td><strong>PSG-7 – Tangible Capital Assets</strong></td>
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<td>The purpose of this Guideline is to provide transitional guidance to a local government on presenting information related to tangible capital assets in notes or schedules to its summary financial statements.</td>
<td>This Guideline is effective for fiscal years beginning on or after January 1, 2007.</td>
<td>No impact on reporting for 2006. In 2007, a note will be required in the financial statements disclosing the status of the process and the known amounts of tangible capital assets to-date. These amounts will also be subject to audit.</td>
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