The Corporation of the Municipality of Kincardine

Audit Findings Report for the period ended December 31, 2018

KPMG LLP

Licensed Public Accountants

Prepared May 30, 2019 for the Council meeting on June 17, 2019

kpmg.ca/audit



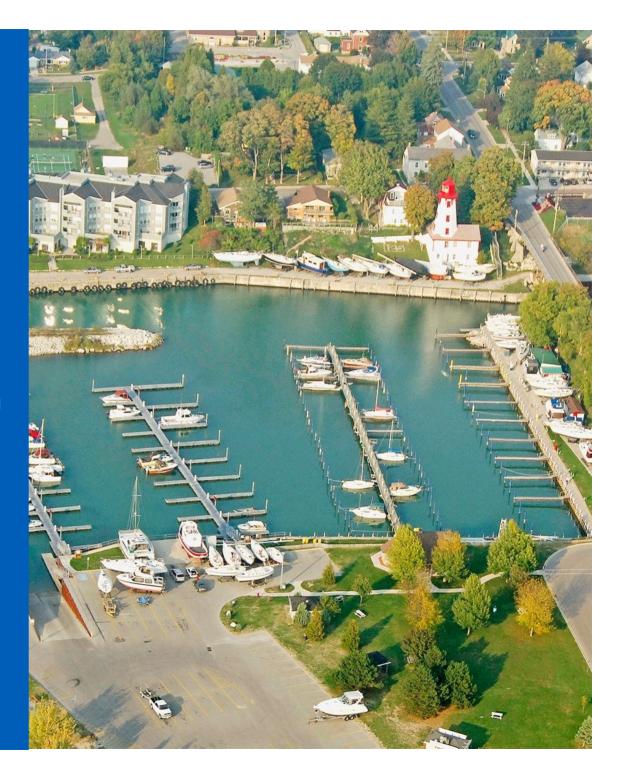


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Executive summary



Purpose of this report*

The purpose of this Audit Findings Report is to assist you, as a member of Council, in your review of the results of our audit of the consolidated financial statements as at and for the year ended December 31, 2018.



Audit materiality

Materiality has been determined based on total revenue. We have determined materiality to be \$1,000,000.



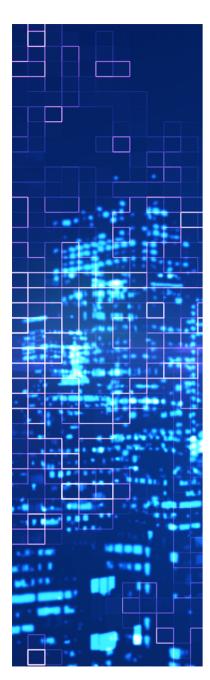
Finalizing the Audit

As of May 30, 2019, we have completed the audit of the consolidated financial statements, with the exception of certain remaining procedures, which include amongst others:

- Receipt of signed management representation letter
- Completing our discussions with Council
- Obtaining evidence of Council's approval of the financial statements

We will update management and Council on significant matters, if any, arising from the completion of the audit, including the completion of the above procedures. Our auditors' report will be dated upon the completion of any remaining procedures.

*This Audit Findings Report should not be used for any other purpose or by anyone other than Council. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this Audit Findings Report has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.



Executive summary



Audit risks and results

Our audit is risk-focused. In conducting our audit we have taken into account key areas of focus for financial reporting. These include and have been addressed in our audit:

- Payroll
- Tangible capital assets
- Taxation revenue
- Bruce Telecom Holdings Inc. transaction
- Debt
- Economic dependence

These risks have been addressed in our audit

See page 5.



Critical accounting estimates

Overall, we are satisfied with the reasonability of critical accounting estimates.

The critical areas of estimates relate to post-employment benefits.

See page 10.



Significant accounting policies and practices

There have been no initial selections of, or changes to, significant accounting policies and practices to bring to your attention.



Executive summary



Adjustments and differences

We did not identify differences that remain uncorrected.



Control and other observations

We did not identify any control deficiencies that we determined to be significant deficiencies in internal control over financial reporting.



Independence

We confirm that we are independent with respect to the Municipality (and its related entities), within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies in Canada and any other standards or applicable legislation or regulation.

Materiality

Materiality determination	Comments	Amount
Materiality	Determined to plan and perform the audit and to evaluate the effects of identified misstatements on the audit and of any uncorrected misstatements on the financial statements. The corresponding amount for the prior year's audit was \$950,000.	\$1 million
Benchmark	Based on an estimate of total revenue for the prior year. This benchmark is consistent with the prior year.	\$47 million
% of Benchmark	The corresponding percentage for the prior year's audit was 2%.	2%
[Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the previous year's audit was \$47,500.	\$50,000

Materiality is used to scope the audit, identify risks of material misstatements and evaluate the level at which we think misstatements will reasonably influence users of the financial statements. It considers both quantitative and qualitative factors.

To respond to aggregation risk, we design our procedures to detect misstatements at a lower level of materiality.

We will report to Council:



Corrected audit misstatements



Uncorrected audit misstatements



Professional requirements

Fraud risk from revenue recognition.

There is no risk resulting from revenue recognition.

Why is it significant?

This is a presumed fraud risk.

We have rebutted this as the risk is considered low given no significant estimates involved with the recognition of tax revenue and the low complexity involved in the deferred revenue recognition policies.

Our audit approach

No impact on our planned audit approach as the risk has been rebutted.

Professional requirements

Fraud risk from management override of controls.

Why is it significant?

This is a presumed fraud risk. We have not identified any specific additional risks of management override relating to this audit.

Our audit approach

As the risk is not rebuttable, our audit methodology incorporates the required procedures in professional standards to address this risk. These procedures include testing of journal entries and other adjustments, performing a retrospective review of estimates and evaluating the business rationale of significant unusual transactions.





Significant findings from the audit regarding other areas of focus are as follows:

Other area of focus	Why are we focusing here?
Payroll	Represents the largest class of expenditures.
Taxation revenue	Represents the largest class of revenue.

Our response and significant findings

Payroll

- A test of operating effectiveness around the new hire and termination controls was conducted. A sample of hires and terminations
 were agreed to supporting documentation and approvals by management to ensure they were appropriate captured in the payroll
 register.
- An expectation for current year wages and benefits was determined utilizing changes in headcount, step increases and changes in accruals.
- No issues were noted by either procedure

Taxation revenue

- KPMG obtained the MPAC assessment roll for the Municipality for 2018 and utilized the effective tax rates passed through current bylaws to build an expectation for taxation revenue. No issues were noted.

KPMG Audit Planning Report



Significant findings from the audit regarding other areas of focus are as follows:

Other area of focus

Why are we focusing here?

Tangible capital assets

Significant caption on the financial statements.

Our response and significant findings

- KPMG statistically selected a sample of current year additions and agreed back to source documentation to determine the appropriate recognition.
- During the current year, it was determined that there were a number of assets discovered by the Municipality that had previously been unrecorded upon the adoption of PSAB Section 3150 Tangible Capital Assets. As a result, the financial statements have a prior year restatement to recognize these historical assets. The impact of the adjustment was an increase in tangible capital assets as of December 31, 2017 of \$2,530,839 increased amortization expense of \$52,471 in each of 2017 and 2018. The details of this adjustment are outlined in note 2 of the financial statements.
- An expectation of current year amortization by asset class was determined based on historic rates and no issues were identified.
- Not taking into account the reduction to tangible capital assets as a result of the Bruce Telecom change, additions for the year amounted to \$16.7 million as opposed to \$5.4 million of amortization. This illustrates how assets are being replaced faster than they are being amortized.



Significant findings from the audit regarding other areas of focus are as follows:

Other area of focus

Why are we focusing here?

Bruce Telecom Holdings Inc. ("Bruce Telecom")

Significant and unique change during the year

Our response and significant findings

- Bruce Telecom Holdings Inc. was incorporated on December 1, 2017 and remains a wholly owned subsidiary of the Municipality. The
 Municipality now accounts for Bruce Telecom as a government business enterprise using the equity method. In the prior year, the
 results of Bruce Telecom had been consolidated into the financial statements of the Municipality.
- As a result of being a Government Business Enterprise, the Municipality is required to account for its investment using the modified equity method. This method records the Municipality's share of net income of Bruce Telecom and not the dividends received annually.
- On January 1, 2018, the Municipality contributed all of the assets and liabilities to Bruce Telecom that were previously owned by the Municipality at their carrying amounts.
- As a result of the January 1, 2018 transaction, and in accordance with the terms of the Asset Transfer Agreement, there were some tangible capital assets (real property) that were transferred from Bruce Telecom back to the Municipality at a total net book value of \$3.8 million. Of these, approximately \$260K were immediately disposed of.
- When Bruce Telecom was established on December 1, 2017, they adopted IFRS as their accounting framework. As a result, the recognition of actuarial gains and losses in the measurement of post-employment benefits was disallowed and resulted in an opening adjustment to accumulated surplus of \$114,816, which is reflected in note 2 to the financial statements.



Significant findings from the audit regarding other areas of focus are as follows:

Other area of focus	Why are we focusing here?
Debt	Represents the largest class of expenditures.
Economic dependence	Represents the largest class of revenue.

Our response and significant findings

Debt

- Confirmations were sent to the Municipality's lenders and ensure that the confirmation and amortization schedules supported the balances recorded by the Municipality as at December 31, 2018.
- Interest expense was recalculated for the year.
- No issues were noted by either procedure
- The Municipality has debt balances with various lenders, which attract various levels of interest. The main balances carry a rate of 2.12% 2.48% with an overall weighted average interest rate in effect of 3.40%.
- The Municipality currently has in excess of \$27.4M (2017 \$28.3M) of unrestricted cash, which is earning interest at prime less 1.6%, which for 2018 would be 2.35%.
- To reduce interest expense there should be consideration as to the ability to pay down debts that have high interest rates compared to current market rates. Some of the higher rate debt will be repaid before the end of 2019, while the tile drain loans which carry a rate of 6% have an offsetting loan receivable with the tax payers.

Economic dependence

Approximately 26% (2017 – 28%), of Municipal tax revenue is generated from the Ontario Power Generation, which is disclosed in the notes to the financial statements



Critical accounting estimates

We have summarized our assessment of the subjective areas.

Asset / liability

Balance (\$'000s)

Post-employment benefits

\$413,560

KPMG comment

Reliance is placed on the actuarial valuation performed by Nexus Actuarial Consultants Ltd. in determining the accrued postemployment benefit liability at the end of each fiscal year. A full actuarial valuation is performed every 3 years and rolled forward based on updated assumptions for each year-end. The last full valuation was performed as of December 31, 2018. We have reviewed the assumptions used by the actuary in their calculations for reasonability. The significant assumptions that have been represented by management and the actuary are as follows:

- 2028 2019
- The accrued benefit obligation at December 31, 2018 is \$613,843 (2017 \$1,383,853), compared to the post-employment liability of \$413,560 (2017 - \$378,795) recorded on the financial statements. The difference between the accrued benefit obligation and the liability is an unamortized actuarial gain.
- The main reason for the decrease over the prior year is the removal of the Bruce Telecom portion which was \$665,707 in 2018.
- Based on our review of the assumptions and the actuarial report, the post-employment benefit liability is properly accrued and
 disclosed in the notes to the financial statements. We have also ensured all related disclosures under the public sector accounting
 standards have been adequately presented in the financial statements.
- No indicators of management bias or misstatements were noted.



Financial statement presentation and disclosure

The presentation and disclosure of the financial statements are, in all material respects, in accordance with the Company's relevant financial reporting framework. Misstatements, including omissions, if any, related to disclosure or presentation items are in the management representation letter.

We also highlight the following:

Form, arrangement, and content of the financial statements

Application of accounting pronouncements issued but not yet effective

Appropriate based on the size, scope and nature of the entity.

Significant accounting policies or practices are disclosed in Note 1 to the financial statements.

No concerns at this time regarding future implementation.

Adjustments and differences



Adjustments and differences identified during the audit have been categorized as "Corrected adjustments" or "Uncorrected differences". These include disclosure adjustments and differences.

Professional standards require that we request of management and the audit committee that all identified adjustments or differences be corrected. We have already made this request of management.

Corrected adjustments

The management representation letter includes all adjustments identified as a result of the audit, communicated to management and subsequently corrected in the financial statements.

Uncorrected differences

We did not identify differences that remain uncorrected.

Current developments and audit trends

Standard	Summary and implications
Restructuring Transactions, Section PSAS 3430	The new standard defines restructuring transactions and establishes standards for recognizing and measuring assets and liabilities transferred in a restructuring transaction. The effective date of this standard is April 1, 2018 (the Municipality's 2019 year-end).
Public Private Partnerships	Identified as a priority in PSAB's 2014 Project Priority Survey, the Board approved a project to develop authoritative guidance specific to public private partnerships. In recent years, governments across Canada are increasingly using various forms of public private partnership arrangements for the provision of assets and delivery of services. This project is expected to develop in two stages. The first stage will involve contemplating specific issues, including project scope, recognition and measurement of a public private partnership and disclosure requirements. Other issues will also be considered. The second stage will involve determining how to account for public private partnerships.
	PSAB established the Public Private Partnerships Task Force Q1 2016. The Statement of Principles was published in 2017, followed by public outreach. The Exposure Draft is being developed and expected to be published in 2019.
Financial Instruments, Section PS3450	A standard has been issued establishing a standard on accounting for and reporting all types of financial instruments including derivatives. The effective date of this standard is April 1, 2021 (the Municipality's 2022 year-end).
	This standard will require the Municipality to identify any contracts that have embedded derivatives and recognize these on the statement of financial position at fair value. Portfolio investments in equity instruments are required to be recorded at fair value. Changes in fair value will be reported in the statement of re-measurement gains and losses. This standard sets out a number of disclosures in the financial statements designed to give the user an understanding of the significance of financial instruments to the Municipality. These disclosures include classes of financial instruments and qualitative and quantitative risk disclosures describing the nature and extent of risk by type. The risks to be considered include credit, currency, interest rate, liquidity, and market risk
Asset Retirement Obligations, Section PS3280	The new section establishes standards on how to account for and report a liability for asset retirement obligations. The main features are:
	- An asset retirement obligation is a legal obligation associated with the retirement of a tangible capital asset.
	- Asset retirement costs associated with a tangible capital asset controlled by the entity increase the carrying amount of the related tangible capital asset (or a component thereof) and are expensed in a rational and systematic manner. Asset retirement costs associated with an asset no longer in productive use are expensed.
	 Measurement of a liability for an asset retirement obligation should result in the best estimate of the amount required to retire a tangible capital asset (or a component thereof) at the financial statement date. A present value technique is often the best method with which to estimate the liability.
	- Subsequent measurement of the liability can result in either a change in the carrying amount of the related tangible capital asset (or a component thereof), or an expense, depending on the nature of the remeasurement and whether the asset remains in productive use.
	This section applies to fiscal years beginning on or after April 1, 2021. Earlier adoption is permitted.

Our discussions with you, our audit opinion and what KPMG is seeing in the marketplace—both from an audit and industry perspective—indicate the following is specific information that will be of particular interest to you. We would, of course, be happy to further discuss this information with you at your convenience.

Thought Leadership	Overview	Links
Accelerate	Accelerate is a KPMG trends report and video series that includes the perspective of subject matter leaders from across KPMG in Canada on seven key issues impacting organizations today that are disrupting the audit committee mandate.	Link to report
The Blockchain shift will be seismic	Blockchain technology is a focused disruptor of the very foundations of external and internal audit: financial recordkeeping and reporting. This Audit Point of View article offers insight on how blockchain technology is impacting business and what audit committees should be thinking about to prepare for certain risks.	<u>Link to report</u>
Audit Quality 2018	Learn about KPMG's ongoing commitment to continuous audit quality improvement. We are investing in new innovative technologies and building strategic alliances with leading technology companies that will have a transformative impact on the auditing process and profession. How do we seek to make an impact on society through the work that we do?	<u>Link to report</u>



Appendices

- Appendix 1: Required communications
- Appendix 2: Audit Quality and Risk Management
- Appendix 3: Management representation letter

Appendix 1: Required communications



In accordance with professional standards, there are a number of communications that are required during the course of and upon completion of our audit. These include:



Auditors' report

The conclusion of our audit is set out in our draft auditors' report attached to the draft financial statements.



Management representation letter

In accordance with professional standards, copies of the management representation letter are provided to Council. The management representation letter is attached in Appendix 3.



Annual independence letter

In accordance with professional standards, we confirm our annual independence.



Related inquiries

Professional standards require that during the completion of our audit, we obtain your views on risk of fraud and other matters.



CPAB Audit Quality Insights Report (October 2018) (formerly the "Big Four Firm Public Report")
CPAB Annual Inspections Results (March 2019)



Appendix 2: Audit Quality and Risk Management



KPMG maintains a system of quality control designed to reflect our drive and determination to deliver independent, unbiased advice and opinions, and also meet the requirements of Canadian professional standards.

Quality control is fundamental to our business and is the responsibility of every partner and employee. The following diagram summarizes the six key elements of our quality control system.

Visit our Audit Quality Resources page for more information including access to our Audit Quality Report.

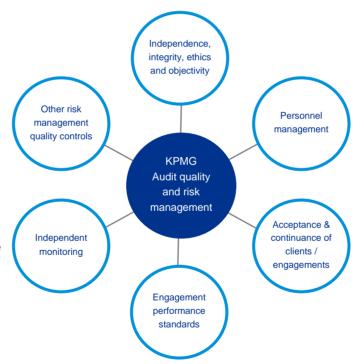
Other controls include:

- Before the firm issues its audit report, the Engagement Quality Control Reviewer reviews the appropriateness of key elements of publicly listed client audits
- Technical department and specialist resources provide real-time support to audit teams in the field

We conduct regular reviews of engagements and partners. Review teams are independent and the work of every audit partner is reviewed at least once every three years.

We have policies and guidance to ensure that work performed by engagement personnel meets applicable professional standards, regulatory requirements and the firm's standards of quality.

 All KPMG partners and staff are required to act with integrity and objectivity and comply with applicable laws, regulations and professional standards at all times.



Ne do not offer services that would impair our independence.

The processes we employ to help retain and develop people include:

- Assignment based on skills and experience
- Rotation of partners
- Performance evaluation
- Development and training
- Appropriate supervision and coaching

We have policies and procedures for deciding whether to accept or continue a client relationship or to perform a specific engagement for that client.

Existing audit relationships are reviewed annually and evaluated to identify instances where we should discontinue our professional association with the client.

Appendix 3: Management representation letter



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