



Appendix B

The Corporation of the City of Markham

**Audit Findings Report
For the year ended December 31, 2017**

April, 2018

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 Council, in your review of the results of our audit of the consolidated financial statements (the “financial statements”) of the Corporation of the City of Markham (“the City”) as at and for the year ended December 31, 2017.

Adjustments and differences

We did not identify any adjustments that were communicated to management and subsequently corrected in the financial statements.

Finalizing the audit

As of April 13, 2018, we have completed the audit of the consolidated financial statements, with the exception of certain remaining procedures, which include amongst others:

- completing our discussions with the audit committee / general committee;
- Obtaining evidence of the Council’s approval of the financial statements;
- Receipt of signed management representation letter (to be signed upon approval if the consolidated financial statements)

We will update the general committee, and not solely the Chair (as required by professional standards), 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.

Control and other observations

We did not identify any control deficiencies that we determined to be significant deficiencies in ICFR.

Executive summary

Critical accounting estimates

Overall, we are satisfied with the reasonability of critical accounting estimates. The critical areas of estimates relate to: depreciation of capital assets, valuation related to land acquisitions, receivables, accruals for employee future benefits.

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.

Independence

We are independent with respect to the City of Markham, 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.

Audit risks and results

Inherent risk of material misstatement is the susceptibility of a balance or assertion to misstatement which could be material, individually or when aggregated with other misstatements, assuming that there are no related controls. We highlight our significant findings in respect of significant financial reporting risks as identified in our discussion with you in the Audit Plan, as well as any additional significant risks identified.

Significant financial reporting risks	Our response and significant findings
Fraud risk from revenue recognition	<ul style="list-style-type: none"> • Our audit approach consisted of substantive procedures to address the relevant assertions associated with this significant risk. • We did not identify any issues related to fraud risk associated with revenue recognition.
Risk of management override of controls	<ul style="list-style-type: none"> • We performed procedures consistent with professional standards including, testing of journal entries, performing a retrospective review of estimates and evaluating the business rationale of significant transactions. • We did not identify any issues or concerns regarding management override of controls
Land Acquisitions	<ul style="list-style-type: none"> • Completeness of land acquisitions had been identified as an area of focus of the audit. • KPMG obtained the listing of land additions provided by the legal department and tested substantively by agreeing to surveyor’s certificates and land title transfer documents in order to ensure that land transfers were appropriate and recorded in the correct fiscal period. • A listing of all land transfers in fiscal 2018 was also obtained and tested substantively to ensure cut-off for fiscal 2017 was appropriate. No errors were noted.
Tangible capital assets	<ul style="list-style-type: none"> • During our substantive testing of tangible capital asset additions, we noted that the City recognized \$290.2M (2016 - \$131.1M) in total additions, which is comprised of \$221.9M (2016 - \$89.5M) of assets capitalized from work in progress (“WIP”), \$46.8 (2016 - \$7.1M) relating to assets capitalized from developer contributions and \$21.4 (2016 - \$34.4M) relating to land purchases/acquisitions. • We reviewed on a sample basis the additions to tangible capital assets and noted that management has correctly capitalized the additions from work in progress to capital assets and developer contributions land acquisitions. • In our testing, we reviewed the developer contributions recognized of \$68.3M (2016 - \$41.5M) on the statement of operations and accumulated surplus and noted that management has appropriately recognized the related revenue.

Audit risks and results (continued)

We identified other areas of focus for our audit in our discussion with you in the Audit Plan.

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

Other areas of focus	Our response and significant findings
Deferred revenue earned	<ul style="list-style-type: none"> • During our substantive testing, we noted that the City recognized \$48.6M (2016 - \$26.9M) of deferred revenue earned. • We obtained the deferred revenue continuity schedule and selected samples for testing to determine if the selected amounts had been recognized in the current year in accordance with the appropriate legislation. • Based on our testing, we conclude that deferred revenue was recognized appropriately.
Markham Enterprises Corporation ("MEC") Investment	<ul style="list-style-type: none"> • The City recognizes its investment in MEC using the modified equity method. • We reviewed the criteria per PS 3070 – Investment in Government Business Enterprises and noted the City's investment in MEC continues to meet all criteria of the section and therefore it is appropriate to continue to record the investment in MEC using the modified equity method of accounting. • We reviewed the MEC modified equity method calculation. We noted that there are three major components to the calculation. They are: MEC's current year net income / other comprehensive income, the gain on amalgamation (see comments on Alectra Inc. below) and MEC's dividend declared and paid to the City. • Based on the work performed, KPMG concludes that management has appropriately reflected its investment in MEC using modified equity accounting in accordance with PS 3070 for fiscal 2017.

Critical accounting estimates

Under IFRS (IAS 1.125), management is required to disclose information in the consolidated financial statements about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to carrying amounts of assets and liabilities within the next financial year. Generally, these are considered to be “critical accounting estimates.”

We have summarized our assessment of the subjective areas:

Asset / liability	KPMG comment
Contingent liabilities	<ul style="list-style-type: none"> The CPA Handbook PS 3300 Contingent Liabilities requires that the City recognize a liability when “...it is likely that a future event will confirm that a liability has been incurred at the date of the financial statements; and the amount can be reasonably estimated.” At any point in time, the City is subject to a number of matters which could potentially result in the determination of a contingent liability as defined above, including, but not limited to matters such as legal claims, contract settlement accruals etc. We reviewed the City’s assessments of contingent liabilities and the process employed to develop and record the estimated liabilities. Where applicable, we met with the individuals responsible for the process and are satisfied that the methodology used is consistent with the approach taken in prior years and has been appropriately reviewed. As these items are resolved, it is possible that the final amounts recorded for these liabilities may change, however the amounts currently recorded represent management’s best estimates of exposure given the information presently available.
Amortization expense	<ul style="list-style-type: none"> We have also reviewed the estimated useful lives of the various additions from work in progress to tangible capital assets and conclude that they are reasonable. Fiscal 2017 amortization expense was recalculated and it was determined that management’s calculation of the amortization expense was appropriate.
Employee future benefits	<ul style="list-style-type: none"> We reviewed actuarial reports regarding estimates related to Employee Future Benefits, and conducted tests of detail to assess the reliability of the information used within the reports. We recalculated the accruals based on the information noted above, and did not identify any discrepancies.

- We believe management’s process for identifying critical accounting estimates is considered adequate.

Other matters

Professional standards require us to communicate Other Matters to Council, such as those relating to the City's related parties, compliance with new accounting standards, and other significant items encountered during the audit.

We have highlighted below other significant matters that we would like to bring to your attention:

Alectra Inc.	<ul style="list-style-type: none"> On February 1, 2017, through a series of transactions, MEC's partially owned operating company, PowerStream, was merged with certain utility holding companies in Ontario to form a new entity, known as Alectra Inc. As part of the merger, MEC disposed all of the outstanding shares of PowerStream in exchange for a 15.73% ownership interest in Alectra Inc. As this transaction is considered to be a non-monetary transaction, the event is required to be valued at the fair value of the proceeds of disposition. Accordingly, the investment in Alectra Inc. is valued at 15.73% of the fair value of the opening value of Alectra Inc. The fair value was determined from an independent appraisal of each of the amalgamating entities. This calculation resulted in MEC recognizing a gain on disposal. In addition, MEC retained a 34.185% interest in Ring Fenced Solar ("RFS"). RFS is a division from PowerStream, carried into Alectra Inc. Only legacy shareholders of PowerStream will be eligible to share in future profits or losses of RFS. The City's share of this gain totaled \$105M. The transaction is described in note 19 of the financial statements. We reviewed the transaction and disclosure in the MEC 2017 draft financial statements and are satisfied that the transaction is appropriately reported within the City's 2017 financial statements.

Data & Analytics in the audit

We have utilized Data & Analytics (D&A) in order to enhance the quality and effectiveness of the audit.

We have summarized areas of the audit where D&A tools and routines were used.

Area(s) of focus	D&A tools and routines	Our results
Journal entry testing	<ul style="list-style-type: none"> • Utilized KPMG application software (IDEA) to: • Evaluate the completeness of the journal entry population through a roll forward of specific accounts • Apply certain criteria to high-risk account population to identify potential high-risk journal entries for further testing. 	<ul style="list-style-type: none"> • We did not identify any issues through our roll-forward procedures • We did not identify any issues with journal entries meeting high risk criteria

Financial statement presentation and disclosure

The presentation and disclosure of the consolidated 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 included in the Appendices. We also highlight the following:

Form, arrangement, and content of the financial statements

KPMG did not note any presentation or disclosure misstatements that have a material impact on the consolidated financial statements.

Application of accounting pronouncements issued but not yet effective

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 differences be corrected. We have already made this request of management.

Corrected adjustments

We did not identify any adjustments that were communicated to management and subsequently corrected in the financial statements.

Uncorrected differences

We did not identify differences that remain uncorrected.

Appendices

Appendix 1: Required communications

Appendix 2: Audit Quality and Risk Management

Appendix 3: Background and professional standards

Appendix 4: Management representation letter

Appendix 5: New Auditor Reporting

Appendix 6: Current developments

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.
- **Management representation letter** – In accordance with professional standards, copies of the management representation letter are provided to the Audit Committee.

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 summarises the six key elements of our quality control systems.

Visit our [Audit Quality Resources page](#) for more information including access to our audit quality report, [Audit quality: Our hands-on process](#).

- 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.



- We 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; and
 - 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: Background and professional standards

Internal control over financial reporting

As your auditors, we are required to obtain an understanding of internal control over financial reporting (ICFR) relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on internal control. Accordingly, we do not express an opinion on the effectiveness of internal control.

Our understanding of ICFR was for the limited purpose described above and was not designed to identify all control deficiencies that might be significant deficiencies and therefore, there can be no assurance that all significant deficiencies and other control deficiencies have been identified. Our awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

The control deficiencies communicated to you are limited to those control deficiencies that we identified during the audit.

Documents containing or referring to the audited financial statements

We are required by our professional standards to read only documents containing or referring to audited financial statements and our related auditors' report that are available through to the date of our auditors' report. The objective of reading these documents through to the date of our auditors' report is to identify material inconsistencies, if any, between the audited financial statements and the other information. We also have certain responsibilities, if on reading the other information for the purpose of identifying material inconsistencies, we become aware of an apparent material misstatement of fact.

We are also required by our professional standards when the financial statements are translated into another language to consider whether each version, available through to the date of our auditors' report, contains the same information and carries the same meaning.

Appendix 4: Management representation letter

Appendix 5: New Auditor Reporting

In response to investors demanding more than a binary pass/fail opinion from the auditors' report, the new and revised auditor reporting standards have introduced significant changes to the traditional auditors' report we provide.

In April 2017, the Auditing and Assurance Standards Board (AASB) in Canada approved the new and revised auditor reporting standards as Canadian Auditing Standards (CASs).

What's new?

Highlights of the new auditors' report include:

Change	Applicability
Re-ordering of the auditors' report including moving opinion to the first section	Listed and non-listed entities
Expanded descriptions of management's, those charged with governance and auditors' responsibilities	Listed and non-listed entities
Disclosure of name of the engagement partner	Listed entities
Description of key audit matters (KAMs)	Applicable only when required by law or regulation or when the auditors is engaged to do so

When are the new requirements effective?

The new and revised standards in Canada will be effective for audits of financial statements for periods ending on or after December 15, 2018 with early application permitted.

U.S. developments

In June 2017, the Public Company Accounting Oversight Board (PCAOB) adopted their enhanced auditor reporting standards which includes, among other requirements, discussion of critical audit matters (CAMs) (similar to KAMs) and tenure of the auditor. Highlights and effective dates of the new U.S. standards are:

- New auditors' report format, tenure and other information: audits for fiscal years ending on or after December 15, 2017
- Communication of CAMs for audits of large accelerated filers: audits for fiscal years ending on or after June 30, 2019
- Communication of CAMs for audits of all other companies: audits for fiscal years ending on or after December 15, 2020.

Impact to Foreign Private Issuers in Canada

Auditors of foreign private issuers (“FPIs”) will still be able to issue a “combined” report (which many FPIs in Canada issue today) that meets both the CAS and enhanced PCAOB standards for 2017 year-end engagements.

Discussions are still underway whether a “combined report” for 2018 year-end engagements will be allowable.

The way forward in Canada

The AASB, working alongside the regulatory bodies, continue to deliberate how the disclosure of KAMs will be required to listed entities in Canada given the recent developments in the U.S.

Appendix 6: Current developments

Please visit the Audit Committee Institute / [Current Developments](#) page for recent developments in IFRS, Canadian securities matters, Canadian auditing and other professional standards and US accounting, auditing and regulatory matters.

The following is a summary of the current developments that are relevant to the Company:

Standard	Summary and implications
PS 3210 Assets	<p>This standard provides a definition of assets and further expands that definition as it relates to control.</p> <p>Assets are defined as follows:</p> <ul style="list-style-type: none"> • They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows. • The public sector entity can control the economic resource and access to the future economic benefits. • The transaction or event giving rise to the public sector entity's control has already occurred. <p>The standard also includes some disclosure requirements related to economic resources that are not recorded as assets to provide the user with better information about the types of resources available to the public sector entity.</p> <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year-end).</p>
PS 3380 Contractual Rights	<p>This standard defines contractual rights to future assets and revenue.</p> <p>Information about a public sector entity's contractual rights should be disclosed in notes or schedules to the financial statements and should include descriptions about their nature and extent and the timing. The standard also indicates that the exercise of professional judgment would be required when determining contractual rights that would be disclosed. Factors to consider include, but are not limited to:</p> <ul style="list-style-type: none"> (a) contractual rights to revenue that are abnormal in relation to the financial position or usual business operations; and (b) contractual rights that will govern the level of certain type of revenue for a considerable period into the future. <p>This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year end.)</p>
PS 2200 Related Party Disclosures	<p>This standard relates to related party disclosures and defines related parties. Related parties could be either an entity or an individual. Related parties exist when one party has the ability to control or has shared control over another party. Individuals that are key management personnel or close family members may also be related parties.</p>

Disclosure is only required when the transactions or events between related parties occur at a value different from what would have been recorded if they were not related and the transactions could have a material financial impact on the financial statements. Material financial impact would be based on an assessment of the terms and conditions underlying the transaction, the financial materiality of the transaction, the relevance of the information and the need for the information to enable the users to understand the financial statements and make comparisons.

This standard also specifies the information required to be disclosed including the type of transactions, amounts classified by financial statement category, the basis of measurement, and the amounts of any outstanding items, any contractual obligations and any contingent liabilities. The standard also requires disclosure of related party transactions that have occurred where no amounts has been recognized.

This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year-end).

PS 3430 Restructuring Transactions

A restructuring transaction in the public sector differs from an acquisition as they generally include either no or nominal payment. It also differs from a government transfer as the recipient would be required to assume the related program or operating responsibility.

The standard requires that assets and liabilities are to be measured at their carrying amount. It also prescribes financial statement presentation and disclosure requirements.

This standard is effective for fiscal periods beginning on or after April 1, 2018 (the City's December 31, 2019 year-end).

PS 3420 Inter-entity Transactions

This standard relates to the measurement of related party transactions and includes a decision tree to support the standard.

Transactions are recorded a carrying amounts with the exception of the following:

- In the normal course of business – use exchange amount
- Fair value consideration – use exchange amount
- No or nominal amount – provider to use carrying amount; recipient choice of either carrying amount or value fair.
- Cost allocation – use exchange amount

This standard is effective for fiscal periods beginning on or after April 1, 2017 (the City's December 31, 2018 year-end).

PS 3450 Financial Instruments

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 has recently been deferred and it is now effective for fiscal periods beginning on or after April 1, 2019 (the City's December 31, 2019 year-end).

This standard will require the City to identify any contracts that have embedded derivatives and recognize these on the consolidated 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 a new financial statement – statement of remeasurement 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 City. 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.

Revised Standard PS 2601 Foreign
Currency Translation

A revised standard has been issued establishing standards on accounting for and reporting transactions that are denominated in a foreign currency.

The effective date of this standard has been deferred and is effective for fiscal periods beginning on or after April 1, 2019 (The City's December 31, 2020 year-end). Earlier adoption is permitted. An entity early adopting this standard must also adopt the new financial instruments standard.

This standard will require exchange gains and losses arising prior to settlement are recognized in a new statement of remeasurement gains and losses.

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