



AUDIT

# The Corporation of the City of Markham

**Audit Findings Report**

For the year ended December 31, 2014

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive style and is underlined with a single horizontal stroke.

April 14, 2015

kpmg.ca

# Contents

<b>Audit findings summary .....</b>	<b>1</b>
<b>Areas of focus .....</b>	<b>2</b>
<b>Significant qualitative aspects of accounting policies and practices .....</b>	<b>5</b>
<b>Appendices .....</b>	<b>6</b>

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# Audit findings summary

## Overview

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 financial statements of the Corporation of the City of Markham ("Markham") as at and for the period ended December 31, 2014.

We appreciate the assistance of management and staff in conducting our audit. We trust that this audit findings report is of assistance to you, and we look forward to discussing our findings and answering your questions.

## Key findings

<b>Areas of focus – Changes from the Audit Plan</b>	<ul style="list-style-type: none"><li>• <b>There have been no changes regarding our audit from the Audit Planning Report previously presented to you.</b></li></ul>
<b>Areas of focus – Significant transactions</b>	<ul style="list-style-type: none"><li>• <b>Tangible capital assets</b></li><li>• <b>Deferred revenues</b></li><li>• <b>Equity investment in Markham Enterprises Corporation ("MEC")</b></li><li>• <b>MEC consolidation</b></li><li>• <b>Contingent liabilities</b></li></ul>
<b>Areas of focus – Matters previously discussed</b>	<ul style="list-style-type: none"><li>• <b>Land acquisitions</b></li></ul>
<b>Significant qualitative aspects of accounting policies and practices</b>	<ul style="list-style-type: none"><li>• <b>Significant accounting policies</b></li><li>• <b>Critical accounting estimates</b></li><li>• <b>Disclosure and financial statement presentation</b></li></ul>
<b>Misstatements</b>	<ul style="list-style-type: none"><li>• <b>We did not identify misstatements that remain uncorrected. As well, we did not identify any misstatements that were communicated to management and subsequently corrected in the financial statements.</b></li></ul>
<b>Control deficiencies</b>	<ul style="list-style-type: none"><li>• <b>We did not identify any control deficiencies that we determined to be significant deficiencies in ICFR.</b></li></ul>

## Finalizing the audit

As of April 14, 2015, we have completed the audit of the financial statements, with the exception of certain remaining procedures, which include:

- Completing our discussions with Council
- Review of the working papers of PowerStream Holdings Inc.'s auditors

- Receipt of legal confirmations
- Receipt of the signed management representation letter (to be signed upon approval of the financial statements)
- Obtaining evidence of the approval of the financial statements

We will update you on significant matters, if any, arising from the completion of the audit, including the completion of the above procedures. Our auditors' report(s) will be dated upon the completion of any remaining procedures.

## Areas of focus

Included in this section are significant matters we believe are appropriate for discussion at the upcoming audit committee meeting. We look forward to discussing these matters and our findings with you.

### Significant transactions

We have highlighted below significant matters related to significant unusual transactions that we would like to bring to your attention:

<b>Tangible Capital Assets</b>
<ul style="list-style-type: none"> <li>• During our substantive testing of the tangible capital assets additions testing, we noted that City recognized 175.2m in total additions in the current year which is comprised of \$130.7m of assets capitalized from work in progress, \$26m relating to assets capitalized from developer contributions and \$18.5m relating to land purchases/acquisitions.</li> </ul>
<b>KPMG comments</b>
<ul style="list-style-type: none"> <li>• We have 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, developer contributions and land purchases/acquisitions.</li> <li>• 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.</li> <li>• In our testing, we also reviewed the developer contribution recognized of \$62.6M on the Statement of Operations and Accumulated Surplus and note that management has appropriately recognized the related revenue.</li> </ul>
<b>Deferred Revenue Earned</b>
<ul style="list-style-type: none"> <li>• During our substantive testing, we noted that the City recognized \$47M of deferred revenue earned in FY2014.</li> </ul>
<b>KPMG comments</b>
<ul style="list-style-type: none"> <li>• We reviewed the deferred revenue continuity schedule and selected samples for testing to determine if the original developer charges received in previous years were used to fund capital expenditures in the current year and in accordance with the appropriate legislation.</li> <li>• Based on our review, we conclude that the developer charges recorded as revenue in 2014 were used to fund capital projects.</li> </ul>

**Markham Enterprises Corporation ("MEC") Equity Investment**

- The City recognizes its investment in MEC using the 'modified equity method'.

**KPMG comments regarding effect on the audit**

- 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, the purchase of MEC shares by the City in 2014 and MEC's dividend declared and paid to the City.
- For the dividend paid to the City, we reviewed the declaration and payment of the dividend by MEC 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 2014.

**Markham Enterprises Corporation ("MEC") Consolidation**

- The CPA Handbook Part I, IAS27 Consolidated and Separate Financial Statements requires that "Intragroup balances, transactions, income and expenses shall be eliminated in full."
- MEC accounts for PowerStream, a joint venture with the City of Barrie and Vaughan, using the proportionate consolidation method.

**KPMG comments**

- We performed substantive work over the MEC consolidation in order to recalculate the City's investment value in MEC for 2014.
- We reviewed the elimination entries recorded and noted the entries were to eliminate the following intercompany transactions: intercompany receivables/payables between MEC, Markham District Energy and PowerStream Holdings Inc. (PowerStream), intercompany sales between Markham District Energy and PowerStream, MEC's investment in Markham District Energy and PowerStream, and the dividend paid by PowerStream to MEC.
- We conclude that the elimination entries are reasonable, in accordance with IFRS, and are consistent in nature with prior year.
- We also reviewed MEC's accounting for PowerStream in the consolidation process. We observed that management appropriately proportionally consolidated its investment in PowerStream based on the percentage ownership of 34.185% on a consistent basis.
- We are also required to review the working papers of PowerStream's auditors.
- For the dividend paid to the City, we reviewed the declaration and payment of the dividend by MEC to the City.
- Based on the work performed, we conclude that the accounting treatment is reasonable in the MEC consolidation.

### **Contingent liabilities**

- 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.

### **KPMG comments**

- We reviewed the City’s assessments of contingent liabilities and the process employed to develop and record the related 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.

## **Matters previously discussed**

We have highlighted below certain significant matters that we have previously discussed with you:

### **Land acquisitions**

- During the F2013 audit of the City, we identified approximately 20.8m in land additions that should have been recorded as additions in prior years resulting in a recast of 2012 comparative figures and 2013 opening balances. This was highlighted in note 21 of the 2013 financial statements.
- In May 2012, the Region of York updated the Regional Development Charges by-laws, which were to become effective June 18, 2012. The new Development Charges rates increased significantly. The by-laws included a pre-payment clause, which effectively allowed developers to pre-pay applicable Development Charges on or before June 18, 2012 at the lower, outgoing by-law rates. A condition of this clause was that subdivision agreements must be executed within six months. This resulted in an unusually high volume of subdivision agreements executed in November and December of 2012. Since the late year land transfers to the City were not captured until after the 2012 cut-off and reconciliation with the Municipal Property Assessment Corporation’s (MPAC) records, they were not recorded until 2013.
- KPMG issued a performance improvement letter with respect to the process of tracking and reporting land additions for the City.

### **Management response**

- The circumstances presented above prompted a review of the process and controls currently in place with regard to recording land acquisitions and sales. The City has refined the process in order to ensure the reporting of land transfers will coincide with the fiscal year.
- The initial step of this improvement is the requirement of the finance department to obtain the surveyor’s certificate provided by the legal department for each transaction. This includes full measurement of land parcels being transferred to the City. Finance is also provided with copies of the transfer documents, showing the transfer of title of land parcels. This permits the City to capture the changes, not included by MPAC, in the final

calendar months of each year. The above process was implemented January, 2014 and remained in effect throughout the fiscal year.

#### **KPMG comments regarding management response**

- 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 2015 was also obtained and tested substantively to ensure cut-off for fiscal 2014 was appropriate. No errors were noted.
- KPMG determined that management's revised process for tracking and reporting land acquisitions is effective.

## **Significant qualitative aspects of accounting policies and practices**

Our professional standards require that we communicate our views regarding the matters below, which represent judgments about significant qualitative aspects of accounting policies and practices. Judgments about quality cannot be measured solely against standards or objective criteria. These judgments are inherently those of the individual making the assessment: the engagement partner. However, although judgments about quality are those of the engagement partner, the views discussed below are not contrary to positions KPMG has taken.

The following are the matters we wish to communicate:

<b>Significant accounting policies</b>	<ul style="list-style-type: none"> <li>• Significant accounting policies are disclosed in Note 1 to the City's financial statements. There were no changes to any significant accounting policies</li> <li>• The new significant accounting policies are disclosed in Note 1 to the financial statements.</li> </ul>
<b>Critical accounting estimates</b>	<ul style="list-style-type: none"> <li>• There were no significant accounting estimates other than depreciation of capital assets, certain valuations related to tangible capital assets (primarily land), receivables, and accruals.</li> </ul>
<b>Critical disclosures and financial statement presentation</b>	<ul style="list-style-type: none"> <li>• The financial statements include disclosures and presentation requirements under the 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.</li> </ul>

# Appendices

**Draft auditors' report**

**Management representation letter**

**Background and professional standards**

**Other current developments**



# Draft auditors' report

To the Members of Council, Inhabitants and Ratepayers  
Of the Corporation of the City of Markham

We have audited the accompanying consolidated financial statements of the Corporation of the City of Markham ("the City"), which comprise the consolidated statement of financial position as at December 31, 2014, the consolidated statement of operations and accumulated surplus, change in net financial assets and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditors' Responsibility**

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 comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the City's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Corporation of the City of Markham as at December 31, 2014, and its consolidated results of operations and accumulated surplus, its consolidated changes in net financial assets and its consolidated cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Chartered Accountants, Licensed Public Accountants

April 28, 2015

Toronto, Canada

# Management representation letter

KPMG LLP  
Yonge Corporate Centre  
4100 Yonge Street, Suite 200  
Toronto, Ontario M2P 2H3  
Canada

April 28, 2015

Ladies and Gentlemen:

We are writing at your request to confirm our understanding that your audit was for the purpose of expressing an opinion on the consolidated financial statements (hereinafter referred to as "financial statements") of The Corporation of the City of Markham ("the Entity") as at and for the period ended December 31, 2014.

We confirm that the representations we make in this letter are in accordance with the definitions as set out in **Attachment I** to this letter.

We confirm that, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

## **GENERAL:**

- 1) We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated February 22, 2013, for:
  - a) the preparation and fair presentation of the financial statements and believe that these financial statements have been prepared and present fairly in accordance with the relevant financial reporting framework.
  - b) providing you with all relevant information and access, such as all financial records and related data and complete minutes of meetings, or summaries of actions of recent meetings for which minutes have not yet been prepared, of shareholders, board of directors and committees of the board of directors that may affect the financial statements, and access to such relevant information.
  - c) such internal control as management determined is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
  - d) ensuring that all transactions have been recorded in the accounting records and are reflected in the financial statements.

**INTERNAL CONTROL OVER FINANCIAL REPORTING:**

- 2) We have communicated to you all deficiencies in the design and implementation or maintenance of internal control over financial reporting of which management is aware.

**FRAUD & NON-COMPLIANCE WITH LAWS AND REGULATIONS:**

- 3) We have disclosed to you:
  - a) the results of our assessment of the risks that the financial statements may be materially misstated as a result of fraud.
  - b) all information in relation to fraud or suspected fraud that we are aware of and that affects the Entity and involves: management, employees who have significant roles in internal control, or others, where the fraud could have a material effect on the financial statements.
  - c) all information in relation to allegations of fraud, or suspected fraud, affecting the Entity's financial statements, communicated by employees, former employees, regulators, or others.
  - d) all known instances of non-compliance or suspected non-compliance with laws and regulations, including all aspects of contractual agreements, whose effects should be considered when preparing financial statements.
  - e) all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

**SUBSEQUENT EVENTS:**

- 4) All events subsequent to the date of the financial statements and for which the relevant financial reporting framework requires adjustment or disclosure in the financial statements have been adjusted or disclosed.

**RELATED PARTIES:**

- 5) We have disclosed to you the identity of the Entity's related parties and all the related party relationships and transactions of which we are aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the relevant financial reporting framework.

**ESTIMATES:**

- 6) Measurement methods and significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

**NON-SEC REGISTRANTS OR NON-REPORTING ISSUERS:**

- 7) We confirm that the Entity is not a Canadian reporting issuer (as defined under any applicable Canadian securities act) and is not a United States Securities and Exchange Commission ("SEC") Issuer (as defined by the Sarbanes-Oxley Act of 2002). We also confirm that the financial statements of the Entity will not be included in the consolidated financial statements of a Canadian reporting issuer audited by KPMG or an SEC Issuer audited by any member of the KPMG organization.

Yours very truly,

THE CORPORATION OF THE CITY OF MARKHAM

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By: Ms. Trinela Cane, Commissioner of Corporate Services

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By: Mr. Joel Lustig, Treasurer

# 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.

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## Other current developments

### Public Sector Accounting Changes (PSAB)

#### New Standard on Financial Instruments

##### Highlights

A new standard has been issued establishing a standard on accounting for and reporting all types of financial instruments including derivatives – PS 3450.

##### Effective date and transition

The standard is effective for fiscal periods beginning on or after April 1, 2016 (applicable for the City in fiscal year 2017), however earlier adoption is permitted. An entity early adopting this standard must also adopt the revised Foreign Currency Translation standard.

##### Implications

This standard will require the City 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 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 on Foreign Currency Translation

##### Highlights

A revised standard has been issued establishing standards on accounting for and reporting transactions that are denominated in a foreign currency – PS 2601.

##### Effective date and transition

The standard is effective for fiscal periods beginning on or after April 1, 2016 (applicable for the City in fiscal year 2017), however earlier adoption is permitted. An entity early adopting this standard must also adopt the new Financial Instruments standard.

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## Implications

Exchange gains and losses arising prior to settlement are recognized in the statement of remeasurement gains and losses.

## New Standard on Liability for Contaminated Sites

### Highlights

A new standard has been issued establishing a standard for the recognition of liabilities for contaminated sites – PS 3260.

### Effective date and transition

This standard is effective for fiscal years beginning on or after April 1, 2014 (applicable for the City in fiscal year 2015), however earlier adoption is encouraged.

### Implications

A liability for remediation of contaminated sites should be recognized when an environmental standard exists, the contamination exceeds the environmental standard, the government is directly responsible or accepts responsibility for the remediation, it is expected future economic benefits will be given up and a reasonable estimate of the amount can be made.

This would only impact the City if a City property was determined to be a contaminated site requiring remediation.

Refer to the KPMG publication “Contaminated Sites – Issues and Implementation Action for PS 3260:

<http://www.kpmg.com/Ca/en/topics/IPO-Services/Documents/Contaminated-Sites-Fall-2013-web-FINAL.pdf>

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