

AUDIT

The Corporation of the City of Markham

Audit Findings Report

For the year ended December 31, 2012

KPMG LLP, Chartered Accountants, Licensed Public
Accountants

kpmg.ca

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Executive summary

Overview

The purpose¹ 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 for the year ended December 31, 2012.

We appreciate the assistance of management and staff in conducting our audit. We hope this audit findings report is of assistance to you for the purpose above.

Status

As of April 15, 2013, we have completed the audit of the financial statements, with the exception of certain remaining procedures which include:

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

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

¹ This Audit Findings Report should not be used for any other purpose or by anyone other than the 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.

Significant audit, accounting and reporting matters

Matters to discuss

Included in this report are significant matters we have highlighted for discussion at the upcoming meeting.

Tangible Capital Assets

- During our substantive testing of tangible capital asset additions testing, we noted that the City recognized \$274M in total additions in the current year which is comprised of \$149M of assets capitalized from work in progress, \$93M relating to assets capitalized from developer contributions and \$31M relating to land purchases/acquisitions.

KPMG comments [regarding effect on the audit]

- 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.
- 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.
- In our testing, we also reviewed the developer contribution recognized of \$124M on the Statement of Operations and Accumulated Surplus and note that management has appropriately recognized the related revenue.

Deferred Revenue Earned

- During our substantive testing, we noted that the City recognized \$63M of deferred revenue earned in FY2012 compared to \$82M in FY2011.

KPMG comments [regarding effect on the audit]

- 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.
- Based on our review, we conclude that the developer charges were used to fund capital projects and therefore management has appropriately recognized deferred revenue as earned revenue in FY2012.

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 2012 and MEC's dividend declared and paid to the City.
- On January 1, 2012, MEC adopted the new required accounting framework, International Reporting Financial Reporting Standards ("IFRS"), as did its wholly owned subsidiary, Markham District Energy, and its joint venture, PowerStream. We have performed substantive work over MEC's transitional adjustments as a result of the adoption of IFRS to opening equity, the transitional adjustment for comparative figures, as well as MEC's 2012 net income and balance sheet items in the MEC standalone audit. We did not identify any difference, or any difference to the equity pick up amount recorded in the City's financial statements.
- 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 PS3070 for fiscal 2012.

Markham Enterprises Corporation ("MEC") Consolidation

- The CICA Handbook Part I, IAS27 Consolidated and Separate Financial Statements requires that *"Intragroup balances, transactions, income and expenses shall be eliminated in full."*

KPMG comments [regarding effect on the audit]

- We performed substantive work over the MEC consolidation in order to recalculate the City's investment value in MEC for 2012.
- 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, 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 conclude that the accounting treatment is reasonable in the MEC consolidation.

Contingent liabilities

- The CICA Handbook PS3300 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 [regarding effect on the audit]

- 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 is 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.

Correction of land additions

- During the audit, we identified an amount of \$5.9 million recorded in expenses relating to the correction of prior period errors relating to land additions.

KPMG comments [regarding effect on the audit]

- We reviewed the supporting documentation to the correction entries and noted that these entries are recorded to correct land capitalized in the prior periods. The corrections relate to duplicated land additions of \$5.2 million, and premature additions of land of \$0.7 million. Total land and land improvement owned by the City as at December 31, 2012 is \$1,654 million (December 31, 2011 - \$1,609 million). The total amount of the correction represents 0.37% of the total land and land improvement owned by the City as at the end of prior period, December 31, 2011.

- We discussed the entries with management and noted that management has processed these corrections as soon as the errors were identified through a review process implemented given the requirements in the municipal environment to include tangible capital assets in their financial statements under the Public Sector Accounting Standards back in 2009. Management has implemented a process to review capitalized land against a list of land owned by the City compiled by third party (documents from MPAC). Per discussion with management, there is currently a 14-month delay in receiving timely third party information. As at the end of 2012, management has on hand a list of land owned by the City up to the Fall of 2011.
- We noted that the duplicated land additions and the premature land additions all relate to assumed land from the creation of subdivisions, and not through any purchase of land. The duplicated land additions relate to updates in acreage from the original date of assuming the land being captured as newly assumed land. The premature recognition of land additions resulted from additional clauses included in selected subdivision agreements with the developers that delay the land transfer date from the completion of the subdivision to the completion of the additional clauses, such as the creation of a park within the subdivision.
- In light of the errors identified by management, we performed additional audit work using the latest documents available to management and did not identify additional items for correction that were not already previously identified through management's review.
- Given that the errors relate to prior periods, we propose these corrections be reversed from the 2012 records and be recorded and corrected to the prior period's financial statements. Management represented that in their judgment, the corrections are not material and decided to have the corrections remain in 2012 expenses.
- We concur with management's assessment.

signature: [illegible]

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:

Other Significant Risks	Results
Fraud and non-compliance with laws and regulations	<ul style="list-style-type: none"> We did not identify: <ul style="list-style-type: none"> any fraud or suspected fraud that may exist involving management, employees who have significant roles in internal control, or others where the fraud results in a material misstatement in the annual financial statements any matters related to fraud that are, in our judgment, relevant to your responsibilities any identified non-compliance with laws or regulations or suspected non-compliance, other than when the identified or suspected non-compliance is clearly inconsequential.
Significant unusual transactions	<ul style="list-style-type: none"> We did not identify any significant unusual transactions.
Modifications to the audit plan	<ul style="list-style-type: none"> We conducted our audit in accordance with our audit plan.
Related parties and related party transactions	<ul style="list-style-type: none"> We did not identify any related party transactions outside the normal course of business that involve significant judgments made by Management concerning measurement and/or disclosure.

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

Misstatements

Identification of misstatements

Misstatements identified during the audit have been categorized as follows:

- corrected misstatements, including disclosures
- uncorrected misstatements, including disclosures.

Corrected misstatements

We did not identify any corrected misstatements.

Management has processed the recommended disclosure related to the notes to the financial statements.

Uncorrected misstatements

Refer to Management's representation letter and the Summary of Uncorrected Audit Misstatements in the Appendices for all uncorrected audit misstatements.

In fiscal 2012, we noted a total of \$5.9 million of uncorrected misstatement. This relates to the correction of a prior period error discussed under "Significant audit, accounting and reporting matters" of this report.

Professional standards require that we request of management and the Council that all uncorrected misstatements be corrected. We have already made this request of management. However, based on both quantitative and qualitative considerations, management has decided not to correct certain misstatements and represented to us that the uncorrected misstatements—individually and in the aggregate—are, in their judgment, not material to the financial statements.

We concur with management's representation that the uncorrected misstatements are not material to the financial statements. Accordingly, the uncorrected misstatements have no effect on our auditors' report.

Appendices

Independence letter

Management representation letter

Independence letter



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PRIVATE & CONFIDENTIAL

Members of the Council
The Corporation of the City of Markham
101 City Centre Boulevard
Markham, Ontario L3R 9W3

April 15, 2013

Dear Members of the Council:

Professional standards specify that we communicate to you in writing all relationships between the Entity and our firm, that may reasonably be thought to bear on our independence.

In determining which relationships to report, we are required to consider relevant rules and related interpretations prescribed by the relevant professional bodies and any applicable legislation or regulation, covering such matters as:

- a) provision of services in addition to the audit engagement
- b) other relationships such as:
 - holding a financial interest, either directly or indirectly, in a client
 - holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client
 - personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client
 - economic dependence on a client

PROVISION OF SERVICES

The following summarizes the professional services rendered by us to the Entity, from January 1, 2012 up to the date of our letter:

- Audit of the 2012 consolidated financial statements of Corporation of the City of Markham.
- Audit of 2012 financial statements of the City of Markham Public Library, Markham District Energy, Markham Enterprises Corporation, the City Trust, the Unionville Business Improvement Area, the Markham Business Improvement Area, the Varley-McKay Art Foundation of Markham, and the Federal Gas Tax Funds Program.

Professional standards require that we communicate the related safeguards that have been applied to eliminate identified threats to independence or to reduce them to an acceptable level. Although we have policies and procedures to ensure that we did not provide any prohibited services and to ensure that we have not audited our own work, we have applied the following safeguards regarding the threats to independence listed above:

- We instituted policies and procedures to prohibit us from making management decisions or assuming responsibility for such decisions.
- We obtained pre-approval of non-audit services and during this pre-approval process we discussed the nature of the engagement and other independence issues related to the services.
- We obtained management's acknowledgement of responsibility for the results of the work performed by us regarding non-audit services and we have not made any management decisions or assumed responsibility for such decisions.

OTHER RELATIONSHIPS

We are not aware of any other relationships between our firm and the Entity that may reasonably be thought to bear on our independence from January 1, 2012 up to the date of our auditors' report.

CONFIRMATION OF INDEPENDENCE

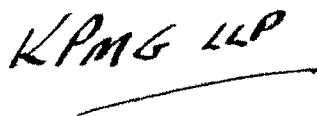
We confirm that we are independent with respect to the Entity within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies and any applicable legislation or regulation from January 1, 2012 up to the date of our auditors' report.

OTHER MATTERS

This letter is confidential and intended solely for use by those charged with governance in carrying out and discharging their responsibilities and should not be used for any other purposes.

KPMG shall have no responsibility for loss or damages or claims, if any, to or by any third party as this letter has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Yours very truly,

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, stylized font. Below the signature is a horizontal line that starts under the "K" and ends under the "P", with a small upward tick at the end.

Chartered Accountants, Licensed Public Accountants

Management representation letter

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

April 30, 2013

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 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, 2012.

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 of the financial statements.
 - b) providing you with all relevant information and access.
 - 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.

COMMITMENTS & CONTINGENCIES:

- 4) There are no:
- a) other liabilities that are required to be recognized and no other contingent assets or contingent liabilities that are required to be disclosed in the financial statements in accordance with the relevant financial reporting framework, including liabilities or contingent liabilities arising from illegal acts or possible illegal acts, or possible violations of human rights legislation.
 - b) other environmental matters that may have an impact on the financial statements.

SUBSEQUENT EVENTS:

- 5) 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:

- 6) 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:

- 7) 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:

- 8) 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.

MISSTATEMENTS:

- 9) The effects of the uncorrected misstatements described in **Attachment II** are immaterial, both individually and in the aggregate, to the financial statements as a whole.

Yours very truly,

THE CORPORATION OF THE CITY OF MARKHAM

By: Ms. Trinela Cane, Commissioner, Corporate Services

By: Mr. Joel Lustig, Treasurer

Attachment I – Definitions

MATERIALITY

Certain representations in this letter are described as being limited to matters that are material. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.

FRAUD & ERROR

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

RELATED PARTIES

In accordance with Canadian public sector accounting standards (PSAB) *related party* is defined as:

- Related parties exist when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two or more parties are related when they are subject to common control, joint control or common significant influence. Two not-for-profit organizations are related parties if one has an economic interest in the other. Related parties also include management and immediate family members.

In accordance with Canadian public sector accounting standards (PSAB) a *related party transaction* is defined as:

- A transfer of economic resources or obligations between related parties, or the provision of services by one party to a related party, regardless of whether any consideration is exchanged. The parties to the transaction are related prior to the transaction. When the relationship arises as a result of the transaction, the transaction is not one between related parties.

Attachment II

Summary of uncorrected audit misstatements

#	Account #	Account Name	Description / Identified During	Error Type	Amount	Income Effect DR (CR)	Impact on financial statement captions - DR(CR)				
							Equity at period end	Current Assets	Non-Current Assets	Current Liabilities	Non-Current Liabilities
1		Opening accumulated surplus General government	To adjust prior period error correction to prior period.	Factual	\$ 5,913,873	\$ -	\$ 5,913,873	\$ -	\$ -	\$ -	\$ -
Total effect of uncorrected audit misstatements					\$ (5,913,873)	\$ (5,913,873)	\$ -	\$ -	\$ -	\$ -	\$ -

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