



City of Nanaimo

Audit Planning Report
For the year ended December 31, 2016

KPMG LLP

September 23, 2016

kpmg.ca/audit



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At KPMG, we are **passionate** about earning your **trust**. We take deep **personal accountability**, individually and as a team, to deliver **exceptional service and value** in all our dealings with you.

At the end of the day, we measure our success from the **only perspective that matters – yours**.

Executive summary

Audit and business risk

Our audit is risk-focused. In planning our audit we have taken into account key areas of focus for financial reporting.

See pages 4-6 and Appendix 2.

KPMG team

The KPMG team will be led by Nancy Adie-MacKay. She will be supported by Liette Bates-Eamer, Senior Manager and Brian Szabo, Engagement Quality Control Review Partner. Subject matter experts will be involved as necessary to ensure our approach is appropriate and robust.

Effective communication

We are committed to transparent and thorough reporting of issues to senior management and the Finance and Audit Committee.

See Appendix 3.

Audit materiality

Materiality has been determined based on estimated total expenses. We have determined materiality to be \$3.5 million for the year ending December 31, 2016.

See page 7.

Independence

We are independent and have extensive quality control and conflict checking processes in place. We provide complete transparency on all services.

This Audit Planning Report should not be used for any other purpose or by anyone other than the Finance and Audit Committee. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this Audit Planning 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.

Current developments

Please refer to Appendix 5 for relevant accounting changes relevant to the City.

Audit approach

Inherent risk 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.

Our assessment of inherent risk is based on various factors, including the size of the balance, its inherent complexity, the level of uncertainty in measurements, as well as significant external market factors or those particular to the internal environment of the entity.

Financial reporting risk	Why	Our audit approach
Financial reporting	Due to the ongoing and significant changes in the accounting and reporting literature and guidance, it is necessary to continually review the financial statements to ensure they are in accordance with Generally Accepted Accounting Principles (GAAP).	Review by the engagement partner and quality control review partner to ensure the disclosure is consistent with current Public Sector Accounting Standards requirements and industry practice. Consultation with the technical resources partner over unusual circumstances.
Information technology	Non-integrated or changing information systems.	Evaluation and testing of the appropriateness and effectiveness of system access and authorization controls during interim audit work. Assess risks relating to integration of systems.
Revenue Recognition	Taxation and fee revenue is recorded accurately and completely.	Perform substantive analytical procedures over tax revenue based on BC Assessment Authority assessed values and Council approved property tax rates by class. Perform tests of controls over utilities fees and select a sample of billings for the year to test accuracy of information. Perform overall analytical procedures to ensure revenue is in line with expectations (budget).

Infrastructure Condition Assessment, Management and Renewal	<p>Capital purchases are accurately recorded and that management assessed its future capital requirements, including replacement cycles. City monitors progress against planned infrastructure renewal to ensure risk of impairment is minimized.</p>	<p>Review the approval and related review process for capital expenditures to ensure they are in line with approved budgets.</p> <p>Review the system controls to ensure that only capital purchases that are approved via the budget process can be processed.</p> <p>Perform substantive procedures such as vouching, analytical procedures over tangible capital assets and amortization.</p> <p>Compare actual spending to annual capital budget and overall replacement program and infrastructure construction progress against capital plan</p> <p>Validate assumptions over remaining useful lives through discussions with engineering and review of replacement/maintenance schedules.</p>
Human Resources	<p>Resource allocation, non-routine contracts, union contract, and incentives, may result in potential accounting issues and budget control issues.</p> <p>Salaries and benefits comprise a significant component of the City's total expenses. As a result, this expense is considered a significant account and the risk of completeness and accuracy is heightened.</p> <p>Measurement of employee future benefits including, sick leave and post-employment gratuity and vacation benefits requires estimates and assumptions to be used.</p>	<p>Review process controls to ensure they identify non-routine payouts.</p> <p>Review contracts to ensure that specific contingencies and settlements have been appropriately recorded.</p> <p>Obtain actuarial determination to support amounts recorded for employee future benefits.</p> <p>Perform substantive procedures such as vouching, testing of cut-off, and analytical procedures over payroll liabilities and expense.</p>

Audit approach

Professional standards presume the risk of fraudulent revenue recognition and the risk of management override of controls exist in all companies.

The risk of fraudulent recognition can be rebutted, but the risk of management override of control cannot, since management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Professional requirements	Why	Our audit approach
Fraud risk from management override of controls	<p>This is a presumed fraud risk in accordance with professional standards.</p> <p>We have not identified any specific additional risks of management override relating to this audit.</p>	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.

Materiality

Professional standards require us to re-assess materiality at the completion of our audit based on period-end results or new information in order to confirm whether the amount determined for planning purposes remains appropriate.




Our assessment of misstatements, if any, in amounts or disclosures at the completion of our audit will include the consideration of both quantitative and qualitative factors.

The first step is the determination of the amounts used for planning purposes as follows.

The determination of materiality requires professional judgment and is based on a combination of quantitative and qualitative assessments including the nature of account balances and financial statement disclosures.

Materiality determination	Comments	Amount
Metrics	Relevant metrics included assets, revenue, and expenses.	
Benchmark	Based on an estimate of total expenses for the year. This benchmark is consistent with the prior year.	\$160 million
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 \$3.5 million.	\$3.5 million
% of Benchmark	The corresponding percentage for the prior year's audit was 2.4%.	2.1%
Performance materiality	Used 75% of materiality, and used primarily to determine the nature, timing and extent of audit procedures. The corresponding amount for the prior year's audit was \$2.625 million.	\$2.625 million
Audit Misstatement Posting Threshold (AMPT)	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the previous year's audit was \$175,000. Different threshold used to accumulated reclassification misstatements.	\$175,000 \$700,000 for reclassification

Highly talented team

	Team member	Discussion of role	Years involved
	Nancy Adie-MacKay Lead Audit Engagement Partner nadie@kpmg.ca (604) 691-3044	<ul style="list-style-type: none"> – Nancy will lead our audit for the City of Nanaimo and be responsible for the quality and timeliness of everything we do. – She will often be onsite with the team and will always be available and accessible to you. 	<ul style="list-style-type: none"> – 5 years as Lead Audit Engagement Partner
	Brian Szabo Engagement Quality Control Reviewer bszabo@kpmg.ca (604) 527-3747	<ul style="list-style-type: none"> – Brian will provide an objective evaluation of the significant judgments made by the lead audit engagement partner and the engagement team, and the conclusions reached in formulating the audit report on the financial statements. 	<ul style="list-style-type: none"> – 5 years as Engagement Quality Control Reviewer
	Liette Bates-Eamer Audit Senior Manager lbateseamer@kpmg.ca (250) 480-3641	<ul style="list-style-type: none"> – Liette will work very closely with Nancy on all aspects of our audit for the City. – She will be on site and directly oversee and manage our audit field team and work closely your management team. 	<ul style="list-style-type: none"> – 2nd year as Audit Senior Manager – 12 years of experience auditing public sector organizations including municipalities, health authorities, school districts, universities and colleges.

Value for fees

In determining the fees for our services, we have considered the nature, extent and timing of our planned audit procedures as described above. Our fee analysis is in accordance with our audit proposal.

Our fees are estimated as follows:

	Current period (budget)	Prior period (actual)
Audit of the annual financial statements	\$38,750	\$42,250

Matters that could impact our fee

The proposed fees outlined above are based on the assumptions described in the engagement letter.

The critical assumptions, and factors that cause a change in our fees, include:

- Significant changes in the nature or size of the operations of the City beyond those contemplated in our planning processes;
- Changes in professional standards or requirements arising as a result of changes in professional standards or the interpretation thereof;
- Changes in the time of our work.

Audit cycle and timetable

Our key activities during the year are designed to achieve our one principal objective:

To provide a robust audit, efficiently delivered by a high quality team focused on key issues.

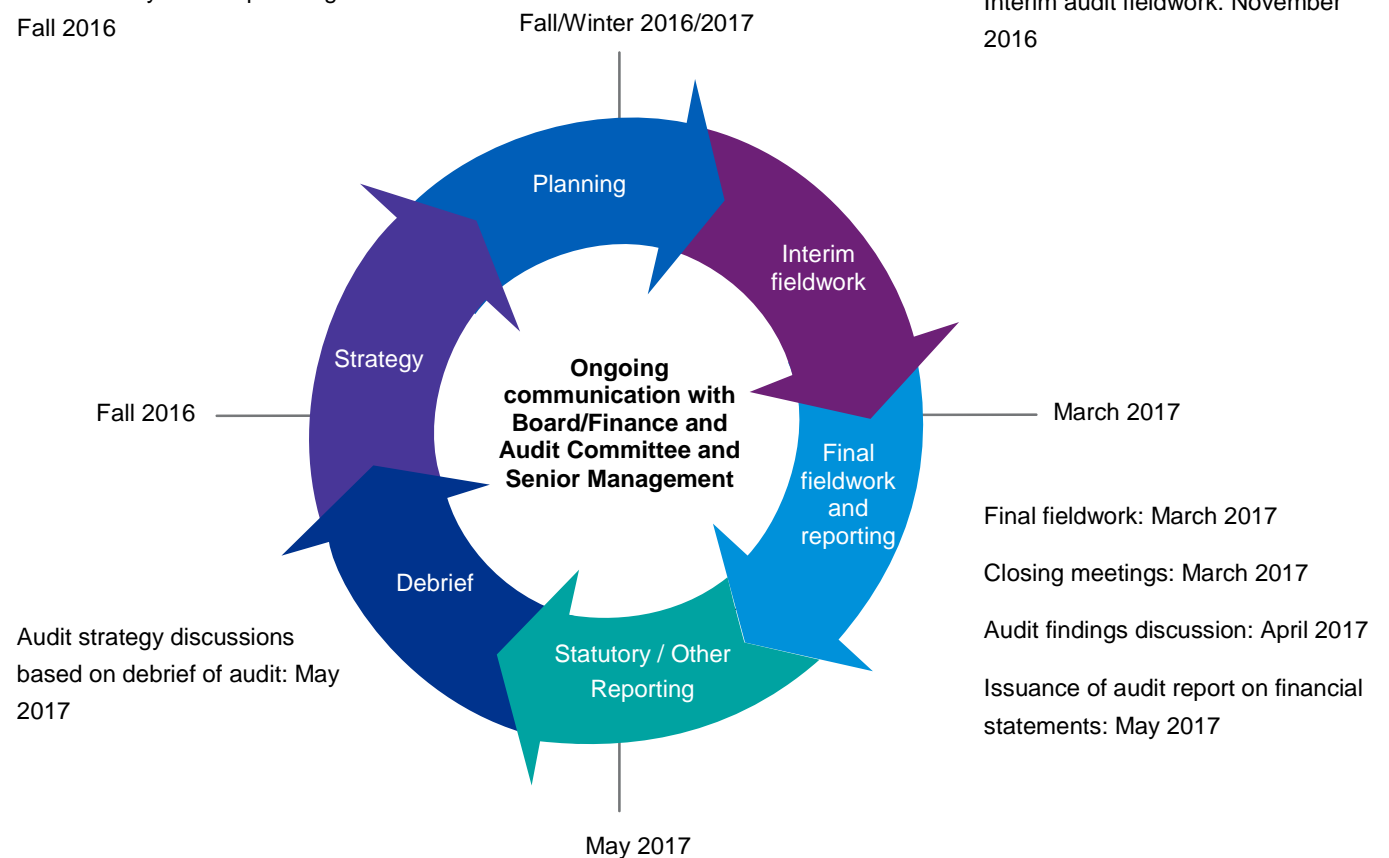
Our timeline is in line with prior year.

Planning meeting with management: Fall 2016

Commence year end planning: Fall 2016

Audit plan discussion with Finance and Audit Committee: October 4, 2016

Interim audit fieldwork: November 2016



Appendices

Appendix 1: Audit quality and risk management

Appendix 2: KPMG's audit approach and methodology

Appendix 3: Required communications

Appendix 4: Data & analytics in audit

Appendix 5: Current developments

Appendix 1: 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, Engagement Quality Control Reviewer reviews the appropriateness of key elements.
 - 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;
 - 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 2: KPMG's audit approach and methodology

Technology-enabled audit workflow (eAudit)

Engagement Setup

- Tailor the eAudit workflow to your circumstances
- Access global knowledge specific to your industry
- Team selection and timetable

Completion

- Tailor the eAudit workflow to your circumstances
- Update risk assessment
- Perform completion procedures and overall evaluation of results and financial statements
- Form and issue audit opinion on financial statements
- Obtain written representation from management
- Required Finance and Audit Committee communications
- Debrief audit process



Risk Assessment

- Tailor the eAudit workflow to your circumstances
- Understand your business and financial processes
- Identify significant risks
- Plan the use of KPMG specialists and others including auditor's external experts, management experts, service organizations auditors, and component auditors
- Determine audit approach
- Evaluate design and implementation of internal controls (as required or considered necessary)

Testing

- Tailor the eAudit workflow to your circumstances
- Perform tests of operating effectiveness of internal controls (as required or considered necessary)
- Perform substantive tests

Appendix 3: Required communications

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

- **Engagement letter** – the objectives of the audit, our responsibilities in carrying out our audit, as well as management's responsibilities, are set out in the engagement letter and any subsequent amendment letters as provided by management.
- **Audit planning report** – as attached.
- **Required inquiries** – professional standards require that during the planning of our audit we obtain your views on risk of fraud and other matters. We make similar inquiries to management as part of our planning process; responses to these will assist us in planning our overall audit strategy and audit approach accordingly.
- **Management representation letter** – we will obtain from management certain representations at the completion of the annual audit. In accordance with professional standards, copies of the representation letter will be provided to the Finance and Audit Committee.
- **Audit findings report** – at the completion of our audit, we will provide a report to the Finance and Audit Committee.

Appendix 4: Data & analytics in audit

Turning data into value

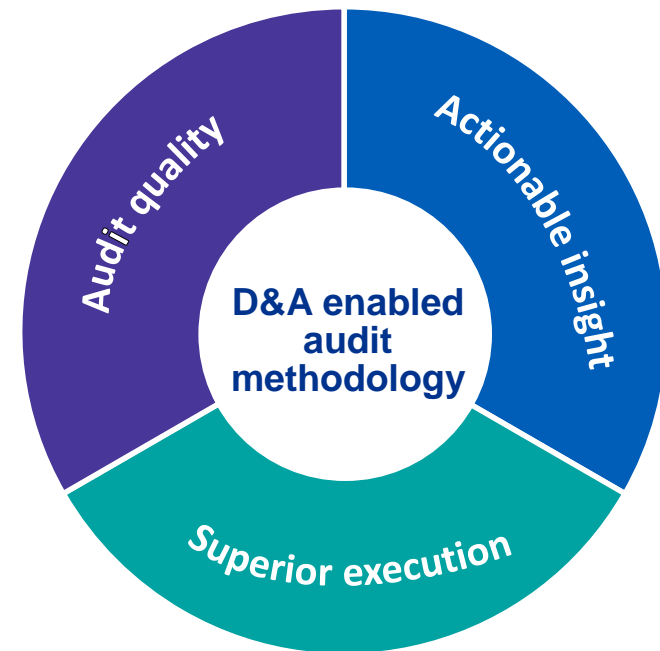
KPMG continues to make significant investments in our Data & Analytics (D&A) capabilities to help enhance audit quality and provide actionable insight to our clients by unlocking the rich information that businesses hold.

When D&A is applied to the audit, it enables us to test complete data populations and understand the business reasons behind outliers and anomalies.

Advancements in D&A tools allow us to analyze data at more granular levels, focusing on higher risk areas of the audit and developing insights you can then leverage to improve compliance, potentially uncover fraud, manage risk and more.

KPMG is enhancing the audit

The combination of our proven industry experience, technical know-how and external data allows us to focus our audit on the key business risks, while providing relevant insights of value to you.



For the audit

Audit quality

- Automated testing of 100% of the population
- Focuses manual audit effort on key exceptions and identified risk areas

For your business

Actionable insight

- Helping you see your business from a different perspective
- How effectively is your organization using your systems?

Appendix 5: Current developments

Public Sector Accounting Standards:

The following is a summary of current Public Sector Accounting Standards developments:

Standard	Summary and implications
Related Party Transactions and Inter-entity Transactions	<p>Two new Handbook sections were approved in December 2014, effective for fiscal years beginning on or after April 1, 2017.</p> <p>Related parties include entities that control or are controlled by a reporting entity, entities that are under common control and entities that have shared control over or that are subject to shared control of a reporting entity.</p> <p>Individuals that are members of key management personnel and close members of their family are related parties. Disclosure of key management personnel compensation arrangements, expense allowances and other similar payments routinely paid in exchange for services rendered is not required.</p> <p>Determining which related party transactions to disclose is a matter of judgment based on assessment of:</p> <ul style="list-style-type: none"> • the terms and conditions underlying the transactions; • the financial significance of the transactions; • the relevance of the information; and • the need for the information to enable users' understanding of the financial statements and for making comparisons. <p>A related party transaction, with the exception of contributed goods and services, should normally be recognized by both a provider organization and a recipient organization on a gross basis.</p> <p>Related party transactions, if recognized, should be recorded at the exchange amount. A public sector entity's policy, budget practices or accountability structures may dictate that the exchange amount is the carrying amount, consideration paid or received or fair value.</p>
Assets, Contingent Assets and Contractual Rights	<p>Three new Handbook sections were approved in March 2015, effective for fiscal years beginning on or after April 1, 2017.</p> <p>The intended outcome of the three new Handbook Sections is improved consistency and comparability.</p> <p>The standard includes enhanced guidance on the definition of assets and disclosure of assets to provide users with better information about the types of resources available to the public sector entity.</p> <p>Disclosure of contingent assets and contractual rights is required to provide users with information about the nature, extent and timing of future assets and potential assets and revenues available to the public sector entity when the terms of those contracts are met.</p>

Restructuring Transactions	<p>A new Handbook section was approved in March 2015, effective for fiscal years beginning on or after April 1, 2018.</p> <p>A restructuring transaction is a transfer of an integrated set of assets and/or liabilities, together with related responsibilities for program delivery or administrative operations, that does not involve a payment or other consideration that approximates the fair value of what is transferred.</p> <p>The new standard requires the transferor remove the assets and liabilities transferred from its books at their carrying amount at the restructuring date. The recipient would recognize the assets and liabilities received at their carrying amount with applicable adjustments at the restructuring date. Both the transferor and the recipient would recognize the net effect of the transfer and any compensation involved as revenue or an expense.</p> <p>Restructuring-related costs are recognized as expenses when incurred.</p> <p>Financial information prior to the restructuring date would not be restated.</p>
Revenue	<p>PSAB is proposing a single framework to categorize revenues to enhance the consistency of revenue recognition and its measurement. A Statement of Principles was issued in 2013 and comments are currently under deliberation.</p> <p>Adoption of these principles would result in a need to assess current accounting policies.</p> <p>In the case of revenues arising from an exchange, a public sector entity must ensure the recognition of revenue aligns with the satisfaction of related performance obligations.</p> <p>For unilateral revenues, recognition occurs when there is authority to record the revenue and an event has happened that gives the public sector entity the right to the revenue.</p>
Asset Retirement Obligations	<p>A new standard is under development addressing the recognition, measurement, presentation and disclosure of legal obligations associated with retirement of tangible capital assets in productive use. Retirement costs would be recognized as an integral cost of owning and operating tangible capital assets. PSAB current contains no specific guidance in this area.</p> <p>In August 2014, a Statement of Principles was issued with responses and feedback solicited by November 2014.</p> <p>PSAB is currently deliberating responses and an exposure draft is under development, expected for release in 2016.</p>
Conceptual Framework	<p>A consultation paper was issued on the conceptual framework and closed in August 2015. A Statement of Principles anticipated in 2016 which includes a number of presentation recommendations to enhance accountability objective of public sector financial statements.</p> <p>A new "Statement of Comprehensive Financial Results" replaces the Statement of Operations and Statement of Remeasurement Gains and Losses.</p> <p>Revenues and expenses to be grouped to show the net results of services.</p> <p>Below net results of services, non-operating items presented such as: grants recognized for the acquisition of tangible capital assets, unrealized remeasurement gains and losses, and unusual transactions.</p> <p>Grants received for the purpose of a tangible capital asset used to provide services for a defined number of years proposed to be recognized in operating revenue as the liability is settled.</p>

Financial Instruments	<p>Effective for governments for fiscal years beginning on or after April 1, 2019.</p> <p>This standard requires that all financial instruments that are equity instruments and trade in an active market or derivatives be recorded at fair value.</p> <p>The standard requires that all other financial instruments are recorded at cost but permits the option of fair value for any financial instruments that are managed and reported at fair value.</p> <p>This standard also includes a requirement to identify and report embedded derivatives separate from the host contract with an option to value the full contract which includes the embedded derivatives at fair value.</p>
Invitation to Comment	<p>PSAB is seeking feedback on an invitation to comment – Serving Public Interest – Improving Information for Accountability and Decision-Making. A draft strategic plan for 2017-2020 has been published, with feedback being accepted until October 2016.</p>

Cyber Security, Is your organization at risk?

Cyber-attacks are an inevitable part of life today, and the financial and reputational costs of not being prepared against such attacks are significant. Cyber-attacks are being launched against all forms of valuable information including both financial and non-financial data sources. Estimates suggest the global financial impact of cybercrime is US\$114 billion; companies are thought to bear almost 80% of those costs. The nature of these attacks and the perpetrators behind them are always changing. Hacktivists, organized criminals, competitors, and even rogue governments are mounting attacks with a high level of sophistication and persistence. These perpetrators have different motives, however are common in that they are looking to either disrupt or better themselves by stealing another entities data.

Patching servers and installing intrusion detection systems is no longer enough to protect your critical assets and business processes. Cyber Security has never been solely about IT; it has always been a business issue first. To survive and prosper requires a business-wide understanding of the threats, safeguards, and responses involved. Key elements to consider include:

- Preparing your people, processes, infrastructure and technology to resist an attack
- Detecting the attack and initiating your response
- Containing and investigating the attack
- Recovering from an attack and resuming business operations
- Reporting on and improving security

Organizations should be reviewing their organization and considering Cyber Risks. Key data that may be identified includes student, banking, payroll data etc.

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