City of Nanaimo

Audit Planning Report
for the year ending
December 31, 2019

KPMG LLP

Prepared for the meeting on
December 2, 2019

kpmg.ca/audit

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Executive summary

We are pleased to provide for your review the following information relating to the planned scope and timing for the audit of the financial statements of the City of Nanaimo (the “Entity”) for the year ended December 31, 2019.

Audit and business risks

Our audit of the Entity is risk-focused. As part of our audit process, we have had discussions with management about any changes in the organization or other items that should be brought to our attention and considered the impact to the audit. In planning our audit, we have taken into account key areas of audit focus for financial reporting.

See pages 3-4.

Audit materiality

Materiality has been determined based on total expenses. We have determined materiality to be $3,700,000.

See page 5.

Independence and Quality Control

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

Current developments

Please refer to pages 8-10 for current developments in Public Sector Accounting Standards.

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.

Audit risks

Professional requirements	Why is it significant?
Fraud risk from revenue recognition.	This is a presumed fraud risk. There are generally pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition when there is an expectation to maintain a balanced budget from year to year.
Fraud risk from management override of controls.	This is a presumed fraud risk. We have not identified any specific additional risks of management override relating to this audit.

Our audit approach

Revenue recognition:

The risk of fraud from revenue recognition has been rebutted. There is no risk resulting from revenue recognition.

Management override:

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.

Audit risks (continued)

Annual inquiries

Professional auditing standards require that we annually inquire concerning the Finance and Audit Committee's oversight of management's process for identifying and responding to the risks of fraud with the Entity. Accordingly, we ask:

– What are your views about fraud risks at the Entity?

– How do you exercise effective oversight of management's processes for identifying and responding to the risk of fraud in the Entity and internal controls management has established to mitigate these fraud risks?

– Are you aware of or have you identified any instances of actual, suspected, or alleged fraud, including misconduct or unethical behaviour related to financial reporting or misappropriation of assets? If so, have the instances been appropriately addressed and how have they been addressed?

– Is the Entity in compliance with laws and regulations?

– Has the Entity entered into any significant unusual transactions?

Materiality

Materiality determination	Comments	Amount
Materiality	Determined to plan and perform the audit and to evaluate the effects of identified misstatements on the audit and of any uncorrected misstatements on the financial statements. The corresponding amount for the prior year's audit was $3,500,000.	$3,700,000
Benchmark	Based on prior year's total expenses for the year. This benchmark is consistent with the prior year.	$158,389,864
% of Benchmark	The corresponding percentage for the prior year's audit was 2.2%.	2.3%
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.	$185,000

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

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

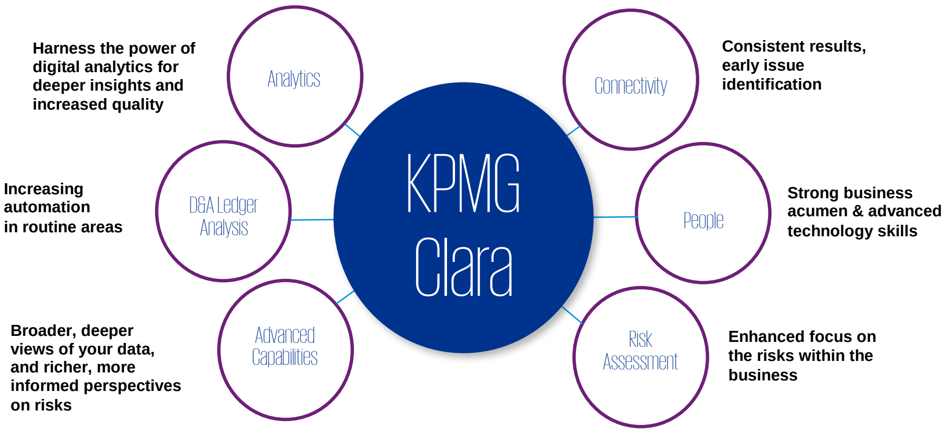
We will report to the Finance and Audit Committee:

- Corrected audit misstatements
- Uncorrected audit misstatements

The audit of today, tomorrow & the future

As part of KPMG's technology leadership, our audit practice has developed technologies and alliances to continuously enhance our capabilities and deliver an exceptional audit experience.

Technology empowers us with the ability to perform deep analysis over your financial information, focusing our effort and interactions on the areas of greatest risk and minimizing disruption to your business.



Technology we use today

Tool	Benefit to audit
Account Analysis Tool	Our account analysis tool provides meaningful general ledger data insights during the planning phase of the audit that can be used to assist the engagement team in obtaining a more thorough understanding of the business processes and underlying flow of transactions through utilization of Account Analysis, Visual Ledger and Journal Entry Analysis functional features. Our tool enables a more precise risk assessment and development of a tailored audit approach.
Journal Entry Analysis	Our journal entry tool assists in the performance of detailed journal entry testing based on engagement-specific risk identification and circumstances. Our tool provides auto-generated journal entry population statistics and focusses our audit effort on journal entries that are riskier in nature.
Visualization Tool	Our Visualization tool is a powerful and flexible end-to-end analytics platform which we leverage to display dynamic visualization of your data. This enables us to provide valuable insights to your business throughout our audit process.
Data & Analytics Routines	Our routines will support addressing the risk of fraudulent management override of control through insight provided by comparing vendor details to those of employees.

Key deliverables and milestones

October 2019

Commence audit planning

November/ December 2019

Present Audit Plan to Finance and Audit Committee

Interim fieldwork

March 2020

Perform year-end fieldwork

April/ May 2020

Present Audit Findings to Finance and Audit Committee

Issue audit opinion

Current developments

Public Sector Accounting Standards

Standard	Summary and implications
Asset Retirement Obligations	– A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2021. – The new standard addresses the recognition, measurement, presentation and disclosure of legal obligations associated with retirement of tangible capital assets in productive use. Retirement costs will be recognized as an integral cost of owning and operating tangible capital assets. PSAB currently contains no specific guidance in this area. – The ARO standard will require the public sector entity to record a liability related to future costs of any legal obligations to be incurred upon retirement of any controlled tangible capital assets ("TCA"). The amount of the initial liability will be added to the historical cost of the asset and amortized over its useful life. – As a result of the new standard, the public sector entity will have to: • consider how the additional liability will impact net debt, as a new liability will be recognized with no corresponding increase in a financial asset; • carefully review legal agreements, senior government directives and legislation in relation to all controlled TCA to determine if any legal obligations exist with respect to asset retirements; • begin considering the potential effects on the organization as soon as possible to coordinate with resources outside the finance department to identify AROs and obtain information to estimate the value of potential AROs to avoid unexpected issues.
Revenue	– A new standard has been approved that is effective for fiscal years beginning on or after April 1, 2022. – The new standard establishes a single framework to categorize revenues to enhance the consistency of revenue recognition and its measurement. – The standard notes that 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. The standard notes that unilateral revenues arise when no performance obligations are present, and 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.
Purchased Intangibles	– In October 2019, PSAB approved a proposal to allow public sector entities to recognize intangibles purchased through an exchange transaction. The proposal does not include guidance on how to account for intangibles. Instead, the definition of an asset, the general recognition criteria and the GAAP hierarchy is expected to provide guidance on how to account for intangibles. The accounting for intangibles may be addressed through future PSAB projects.

Current developments (continued)

Standard	Summary and implications
International Strategy	– PSAB is in the process of reviewing its current approach towards International Public Sector Accounting Standards. This project may result in changes to the role PSAB plays in setting standards in Canada. – Consultation papers were released for comment in May 2018 and March 2019, and have closed. The consultation papers described the decision-making criteria PSAB expects to consider in evaluating the international strategy that best serves the public sector. It also introduced four proposed international strategies. – PSAB is expected to make a final decision about its international strategy at its March 2020 meeting.
Financial Instruments and Foreign Currency Translation	– New accounting standards, PS3450 *Financial Instruments*, PS2601 *Foreign Currency Translation*, PS1201 *Financial Statement Presentation* and PS3041 *Portfolio Investments* have been approved by PSAB and are effective for years commencing on or after April 1, 2021. – Equity instruments quoted in an active market and free-standing derivatives are to be carried at fair value. All other financial instruments, including bonds, can be carried at cost or fair value depending on the public sector entity's choice and this choice must be made on initial recognition of the financial instrument and is irrevocable. – Hedge accounting is not permitted. – A new statement, the Statement of Remeasurement Gains and Losses, will be included in the financial statements. Unrealized gains and losses incurred on fair value accounted financial instruments will be presented in this statement. Realized gains and losses will continue to be presented in the statement of operations. – Based on stakeholder feedback received, PSAB is considering certain scope amendments to PS 3450 *Financial Instruments*. The proposed amendments include the accounting treatment of bond repurchases, scope exclusions for certain activities by the federal government, and improvements to the transitional provisions. An initial exposure draft was issued for comment by PSAB in May 2019. PSAB is currently deliberating on the comments received and may approve a revised exposure draft for comment in December 2019.
Employee Future Benefit Obligations	– PSAB has initiated a review of sections PS3250 *Retirement Benefits* and PS3255 *Post-Employment Benefits, Compensated Absences and Termination Benefits*. Given the complexity of issues involved and potential implications of any changes that may arise from this review, the project will be undertaken in phases. Phase I will address specific issues related to measurement of employment benefits. Phase II will address accounting for plans with risk sharing features, multi-employer defined benefit plans and sick leave benefits. – Three Invitations to Comment were issued and have closed. The first Invitation to Comment sought guidance on whether the deferral provisions in existing public sector standards remain appropriate and justified and the appropriateness of accounting for various components of changes in the value of the accrued benefit obligation and plan assets. The second Invitation to Comment sought guidance on the present value measurement of accrued benefit obligations. A third Invitation to Comment sought guidance on non-traditional pension plans. PSAB is currently deliberating on the comments received from the three Invitations to Comment. – The ultimate objective of this project is to issue a new employment benefits section to replace existing guidance.

Current developments (continued)

Standard	Summary and implications
Public Private Partnerships (“P3”)	– PSAB has proposed new requirements for the recognition, measurement and classification of infrastructure procured through a public private partnership. An exposure draft has been approved by PSAB and will be issued in November 2019, with comments due by February 29, 2020. – The exposure draft proposes that recognition of infrastructure by the public sector entity would occur when it controls the purpose and use of the infrastructure, when it controls access and the price, if any, charged for use, and it controls any significant interest accumulated in the infrastructure when the P3 ends. – The exposure draft proposes that the public sector entity recognize a liability when it needs to pay cash or non-cash consideration to the private sector partner for the infrastructure. • The infrastructure would be valued at cost, with a liability of the same amount if one exists. Cost would be measured by discounting the expected cash flows by a discount rate that reflects the time value of money and risks specific to the project.
Concepts Underlying Financial Performance	– PSAB is in the process of reviewing the conceptual framework that provides the core concepts and objectives underlying Canadian public sector accounting standards. – A Statement of Concepts (“SOC”) and Statement of Principles (“SOP”) were issued for comment in May 2018 and has closed. PSAB is in the process of developing two exposure drafts for comment. – The SOC proposes a revised, ten chapter conceptual framework intended to replace PS 1000 *Financial Statement Concepts* and PS 1100 *Financial Statement Objectives*. The revised conceptual framework would be defined and elaborate on the characteristics of public sector entities and their financial reporting objectives. Additional information would be provided about financial statement objectives, qualitative characteristics and elements. General recognition and measurement criteria, and presentation concepts would be introduced. – The SOP includes principles intended to replace PS 1201 *Financial Statement Presentation*. The SOP proposes: • Removal of the net debt indicator, except for on the statement of net debt where it would be calculated exclusive of financial assets and liabilities that are externally restricted and/or not available to settle the liabilities or financial assets. • Changes to common terminology used in the financial statements, including re-naming accumulated surplus (deficit) to net assets (liabilities). • Restructuring the statement of financial position to present non-financial assets before liabilities. • Removal of the statement of remeasurement gains (losses) with the information instead included on a new statement called the statement of changes in net assets (liabilities). This new statement would present the changes in each component of net assets (liabilities). • A new provision whereby an entity can use an amended budget in certain circumstances. – Inclusion of disclosures related to risks and uncertainties that could affect the entity’s financial position.

Appendices

Appendix 1: Audit quality and risk management

Appendix 2: KPMG’s audit approach and methodology

Appendix 3: Lean in Audit™

Appendix 4: Required Communications

Appendix 5: Audit Approach

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 most recent Audit Quality and Transparency Report.

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. We do not offer services that would impair our independence.

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.

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

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

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

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

Other controls include:

- Before the firm issues its audit report, 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

Appendix 2: KPMG's audit approach and methodology

This year we will expand our use of technology in our audit through our new smart audit platform, KPMG Clara.

Collaboration in the audit

A dedicated KPMG Audit home page gives you real-time access to information, insights and alerts from your engagement team

Issue identification

Continuous updates on audit progress, risks and findings before issues become events

Data-driven risk assessment

Automated identification of transactions with unexpected or unusual account combinations – helping focus on higher risk transactions and outliers

Deep industry insights

Bringing intelligence and clarity to complex ssues, regulations and standards

Analysis of complete populations

Powerful analysis to quickly screen, sort and ilter 100% of your journal entries based on high-risk attributes

Reporting

Reporting nteractive reporting of unusual patterns and rends with the ability to drill down to ndividual transactions

Appendix 3: Lean in Audit™

An innovative approach leading to enhanced value and quality

Our innovative audit approach, Lean in Audit, further improves audit value and productivity to help deliver real insight to you. Lean in Audit is process oriented, directly engaging organizational stakeholders and employing hands-on tools, such as walkthroughs and flowcharts of actual financial processes.

By embedding Lean techniques into our core audit delivery process, our teams are able to enhance their understanding of the business processes and control environment within your organization – allowing us to provide actionable quality and productivity improvement observations.

Any insights gathered through the course of the audit will be available to both engagement teams and management. For example, we may identify control gaps and potential process improvement areas, while management has the opportunity to apply such insights to streamline processes, inform business decisions, improve compliance, lower costs, increase productivity, strengthen customer service and satisfaction and drive overall performance.

How it works

Lean in Audit employs three key Lean techniques:

1. Lean training

Provide basic Lean training and equip our teams with a new Lean mindset to improve quality, value and productivity.

2. Interactive workshops

Perform interactive workshops to conduct walkthroughs of selected financial processes providing end-to-end transparency and understanding of process and control quality and effectiveness.

3. Insight reporting

Quick and pragmatic insight report including immediate quick win actions and prioritized opportunities to realize benefit.

Appendix 4: 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:

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.

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 planning report

This report.

Audit findings report

At the completion of our audit, we will provide our audit findings to the Finance and Audit Committee.

Independence

At the completion of our audit, we will re-confirm our independence to the Finance and Audit Committee.

Appendix 5: Audit Approach

Account	Audit Approach
Tangible capital assets and deferred development cost charges	- Review the approval and related review process for capital expenditures to ensure they are in line with approved budgets. - Perform substantive procedures such as agreeing additions to supporting documentation, analytical procedures over tangible capital assets and amortization. - Compare actual spending to annual capital budget and overall replacement program and infrastructure construction progress against capital plan. - Validate assumptions over remaining useful lives through discussions with engineering and review of replacement/maintenance schedules. - Test deferred capital contributions received to ensure amounts are appropriately restricted and accurately recorded. - Review management's assessment of contaminated sites and verify completeness and reasonableness of liabilities recognized. - Review agreements for contractual commitments and related disclosure requirements.
Salaries and benefits	- Perform substantive procedures such as testing of cut-off and analytical procedures over payroll liabilities and expense. - Review of assumptions and method used in estimating the liability of future employee benefits to ensure the assumptions and methods used are reasonable and consistent with Public Sector Accounting Standards. - Retrospective review of management's previous estimates. - Review contracts to ensure that specific contingencies and settlements have been appropriately recorded.

Appendix 5: Audit Approach (continued)

Account	Audit Approach
Cash and investments	- Agree cash balances to bank reconciliations and bank confirmations. - Agree recorded values of investments to the investment manager confirmation. -
Revenue and receivables management	- Perform substantive analytical procedures over tax revenue based on BC Assessment Authority assessed values and Council approved property tax rates by class. - Disaggregated analytical testing of revenue balances compared to prior year and budget. - Assessment of revenue recognition in accordance with Public Sector Accounting Standards.
Expenses, procurement and payables	- Perform a search for unrecorded liabilities by testing payments made subsequent to year end. - Perform analytical procedures comparing actual balances to expectations. - Test expense reports (at both the management and Council level) to ensure appropriate review and compliance with the City's reimbursement policies.

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