Appendix C

Board of Governors of Exhibition Place

(A Board controlled by the City of Toronto)

Audit Findings Report
for the year ended December 31, 2021

KPMG LLP

Licensed Public Accountants

Prepared on May 4, 2022

kpmg.ca/audit

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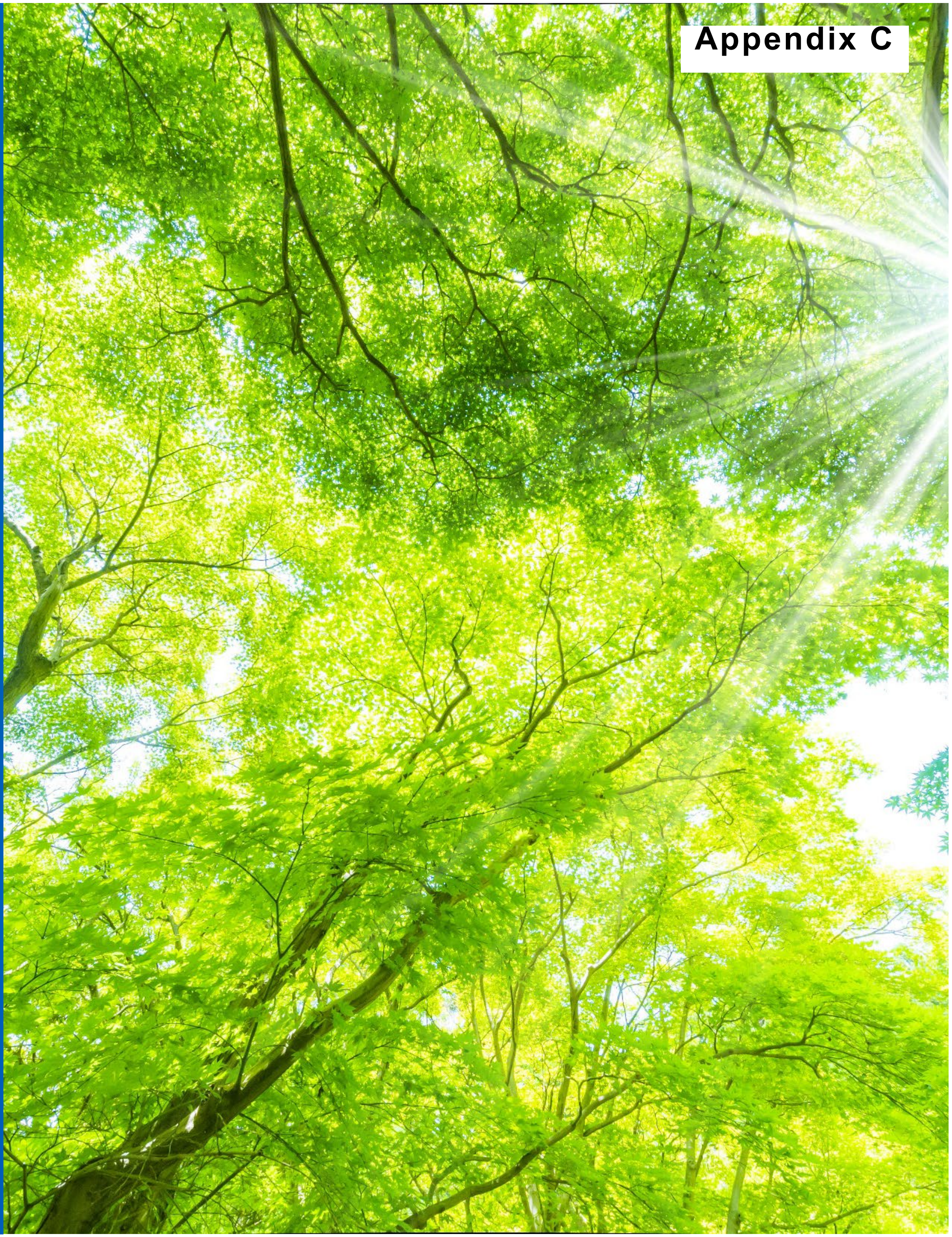

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KPMG contacts

The contacts at KPMG in connection with this report are:

DIANE DEL MONTE

Audit Engagement Partner

Tel: (416) 549-7775
ddelmonte@kpmg.ca

SHELYANE LI

Audit Senior Manager

Tel: (416) 224-4113
shelyaneli@kpmg.ca

Our refreshed Values

What we believe

Integrity

We do what is right.

Excellence

We never stop learning and improving.

Courage

We think and act boldly.

Together

We respect each other and draw strength from our differences.

For Better

We do what matters.

Audit Quality: How do we deliver audit quality?

Transparency report

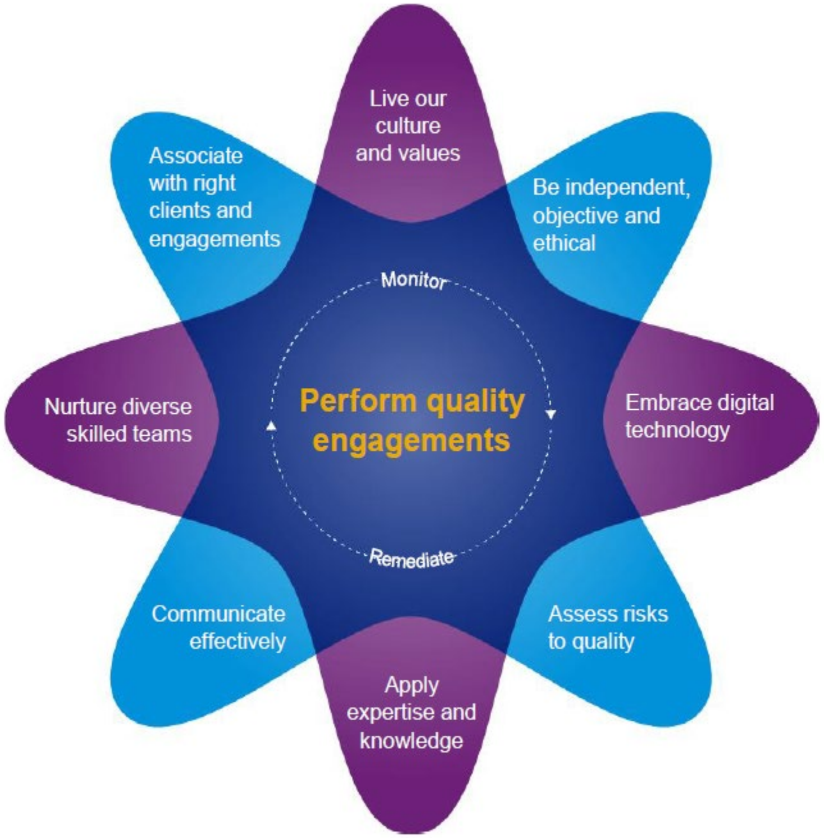
Quality essentially means doing the right thing and remains our highest priority. Our **Global Quality Framework** outlines how we deliver quality and how every partner and staff member contributes to its delivery.

'**Perform quality engagements**' sits at the core along with our commitment to continually monitor and remediate to fulfil on our quality drivers.

Our **quality value drivers** are the cornerstones to our approach underpinned by the **supporting drivers** and give clear direction to encourage the right behaviours in delivering audit quality.

We define '**audit quality**' as being the outcome when:

- audits are **executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls;** and
- all of our related activities are undertaken in an environment of the utmost level of **objectivity, independence, ethics,** and **integrity.**



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Doing the right thing. Always.

Audit highlights

Purpose of this report[1]

The purpose of this report is to assist you, as a member of the Board of Governors of Exhibition Place, in your review of the results of our audit of the financial statements as at and for the year ended December 31, 2021.

Group reporting

The Board of Governors of Exhibition Place ("Exhibition Place") is controlled by the City of Toronto (the "City") and thus Exhibition Place's financial results are consolidated into the City's consolidated financial statements. The audit engagement team for the City (the "Group auditor") has noted that they will use the work of our audit and the auditors' report related to Exhibition Place's financial statements. Exhibition Place is considered a non-significant component for the audit of the City, i.e. the group audit.

In accordance with Canadian auditing standards, we will be communicating matters of significance to the group auditor throughout the audit including planning and risk assessment, execution and reporting.

Status of the audit

As of the date of this report, we have completed the audit of the financial statements, with the exception of certain remaining procedures, which include amongst others:

- completing our discussions with the Board of Governors
- completing subsequent events procedures, including legal updates, up to the date of approval of the financial statements
- receipt of the signed management representation letter (dated upon Board approval of the financial statements)
- obtaining evidence of the Board's approval of the financial statements.

We will update the Board, and not solely the Chair, on significant matters, if any, arising from the completion of the audit, including the completion of the above procedures.

Our auditors' report, a draft of which is provided with the draft financial statements, will be dated upon the completion of any remaining procedures.

Materiality

Materiality has been established by considering various metrics that are relevant to the users of the financial statements, including total expenses. We have determined materiality to be $900,000.

See page 6.

Uncorrected audit misstatements

We did not identify any adjustments that remain uncorrected.

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

[1] This report to the Board of Governors is intended solely for the information and use of Management and the Board of Governors and should not be used for any other purpose or by any other party. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this 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.

Control deficiencies

We did not identify any control deficiencies that we determined to be significant deficiencies in internal control over financial reporting. A significant deficiency in internal control is a deficiency, or combination of deficiencies, in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

Other matters

We have identified other matters. See page 12.

Significant accounting policies and practices

There have been no initial selections of, or changes to, significant accounting policies and practices effective in the current year to bring to your attention.

Materiality

Materiality is established to identify risks of material misstatements, to develop an appropriate audit response to such risks, and to 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 (e.g., performance materiality).

Materiality determination	Comments	Amount
Materiality	The corresponding amount for the prior year's audit was $1,225,000.	$900,000
Benchmark **(the metric that is *most* relevant to the users)**	Based on total preliminary expenses for the year. This benchmark is consistent with the prior year.	$33 million
% of Benchmark	The corresponding percentage for the prior year's audit was 3%.	3%
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 $922,000.	$675,000
Audit Misstatement Posting Threshold	Threshold used to accumulate misstatements identified during the audit. The corresponding amount for the prior year's audit was $61,000.	$45,000

Audit risks and results

We highlight our significant findings in respect of **significant financial reporting risks.**

Significant risk – professional requirements	Why is it significant?
Presumption of the risk of fraud involving improper revenue recognition.	This is a presumed risk of material misstatement due to fraud. We have not identified any risk of material misstatement resulting from fraudulent revenue recognition.

Our response

- Although there is a presumption that there are risks of fraud in revenue recognition, this presumption may be rebutted. We have exercised professional judgment and have rebutted this presumed risk. We have done this primarily because no risk factors have been identified.
- Exhibition Place's primary revenue sources are building rentals, parking and sales of services. Revenues are non-complex, supported by cash receipts and contracts, and they do not involve elements of significant judgment.
- This fraud risk could include manual journal entries and other adjustments to manipulate revenue recognition, however, we have determined that there is no risk resulting from revenue recognition.

Significant findings

- As part of our audit approach to address the inherent risk of error in revenue recognition, we substantively tested revenues (both recognized and amounts held as deferred at year end) using sampling techniques and direct confirmation of certain revenues.
- We recalculated management's calculation of deferred revenue through auditing management's methodology.
- There were no issues after performing these procedures.

Audit risks and results

Significant risk – professional requirements	Why is it significant?
Presumption of the risk of fraud resulting from management override of controls.	Management is 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. Although the level of risk of management override of controls will vary from entity to entity, the risk nevertheless is present in all entities.

Our response

As this presumed risk of material misstatement due to fraud is not rebuttable, our audit methodology incorporates the required procedures in professional standards to address this risk.

- We have utilized D&A in order to enhance the quality and effectiveness of our testing of journal entries. Using extractions of all journal entries recorded during the year, we selected samples and verified if they were supported by proper documentation and followed the journal entry initiation and approval controls and processes in place.
- We also evaluated the reasonableness of estimates. We found that management's process for identifying accounting estimates is considered adequate.
- We evaluated the business rationale of significant unusual transactions.
- Additionally, we incorporated an element of unpredictability whereby we performed an unpredictable procedure to address the potential risk of fraud and management override.

Significant findings

- We did not note any significant control deficiencies in our evaluation of the design and implementation and test of operating effectiveness of selected relevant controls over financial reporting.
- We tested journal entries and other adjustments by using D&A routines. See page 15 for further details in this area.
- We did not identify any issues or concerns after performing our review of estimates. See pages 9 and 10 for further details in this area.
- We did not identify any significant unusual transactions or any specific additional risks of management override during our audit.
- We carried out our element of unpredictability by testing a sample of procured goods and services and inspecting for evidence of appropriate authorization prior to procurement. We did not identify any issues after completing this element of unpredictability.

Other areas of focus and results

We highlight our significant findings in respect of **other areas of focus**.

Valuation of accounts receivable	New or changed?	Estimate?
Accounts receivable are required to be recorded at their expected realizable value in accordance with Public Sector Accounting Standards (PSAS).	Same as prior year.	Yes, there is estimation uncertainty regarding collectability of receivable balances.

Our response

Our procedures included:

- Obtaining management's analysis of collectability of receivable balances and obtaining corroborative evidence of collectability for amounts not provided for.
- Direct confirmation with a sample of tenants and debtors.
- Subsequent receipts testing.

Significant findings

- Trade receivables at the end of 2021 are $10.6M (2020 - $5.8M).
- The allowance for doubtful accounts increased by $174.5K from 2020 (2020 – increase by $1.8M from 2019).
- Management completed a detailed assessment by customer, with consideration of the age of the receivable and whether the customer was approved by the City for the rent deferral or abatement programs.
- As this is an area of estimate, we evaluated management's analysis and concur with management's assessment. Trade accounts receivable is fairly stated as at December 31, 2021.

Other areas of focus and results

Employee future benefits (EFB)	New or changed?	Estimate?
Management is required to disclose information in the financial statements about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to carrying amounts of assets and liabilities within the next financial year.	Same as prior year, with a valuation completed in the current year.	Yes, there is estimation uncertainty due to assumptions used by the actuary to calculate the liability for the Employee Future Benefits.

Our response

Our procedures included:

- Reliance on actuaries (management specialist) engaged by the City; obtaining an understanding of the activities over the quality of information used, the assumptions made, the qualifications, competence and objectivity of the preparer of the estimate, and the historical accuracy of the estimates.
- Assessing the method, data, and assumptions used by the actuary and management in the calculation of the EFB liability for reasonableness.
- Communicating with actuaries and testing the HR data provided to the actuaries.
- Utilizing KPMG specialists (KPMG Life & Pensions Actuarial Practice), we reviewed and evaluated the assumptions used in the actuarial reports.
- Assessing the disclosures in the financial statements in accordance with the requirements of PSAS.

Significant findings

- On behalf of Exhibition Place, the City engaged an external actuarial consultant (the "Actuary") to undertake a valuation of the City's non-pension retirement benefits and accumulated sick leave liability as at December 31, 2021. A valuation was performed to determine the liability as reported in Exhibition Place's 2021 financial statements. Discount rates ranging from 1.6% to 2.6% (2020 – 1.2% to 2.0%) were used for the determination of the liability.
- The employee future benefits liability as at December 31, 2021 is described in note 6 to the financial statements.
- We obtained the plan membership data compiled by management and provided to the Actuary for performing their valuation as at December 31, 2021. On a sample basis, we selected individuals participating in the various plans and verified the relevant information to source documents, such as HR and payroll records.
- Based on our review of the Actuary's report, we noted that the method applied for the estimate is acceptable per CIA and PSAS 3250 *Retirement Benefits*.
- We engaged KPMG Actuary Specialists to assess the reasonableness of the key assumptions used in the valuation.
- We note that the discount rate used by the Actuary is a key assumption. We evaluated the discount rate used against the discount rate curve issued by different reliable sources including CIA, FIERA and KPMG LLP. Based on this evaluation, we conclude that the discount rate used is reasonable.
- The disclosures included in the financial statements are in accordance with the requirements of PSAS.
- We did not note any issues related to the calculation of Exhibition Place's non-pension retirement benefits and accumulated sick leave liability as at December 31, 2021.

Other areas of focus and results

Contingent liabilities	New or changed?	Estimate?
PSAS 3300 *Contingent Liabilities* requires that Exhibition Place 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.	Same as prior year	Estimation uncertainty exists related to the likelihood and measurement of the contingent liability. However, this estimation uncertainty does not result in a risk of material misstatement.

Our response

- We obtained a listing of active litigation and potential claims from management and reviewed management's assessments of each matter and the process employed to develop and record the related estimated liabilities.
- We obtained a legal confirmation from City legal and external counsel and evaluated the assessments made by management on the advice of legal counsel on the pending legal matters in terms of determination of likelihood and measurability.
- We reviewed Board meeting minutes to determine the completeness of contingencies and held discussions thereon with management.

Significant findings

- At any point in time, Exhibition Place is subject to a number of employment grievances and other 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, etc.
- Based on the audit work performed, we are satisfied that the method, data, and assumptions used by management are reasonable and consistent with the industry norms, and there are no issues to report.

Other matters

Professional standards require us to communicate to the Board of Governors other matters.

We have highlighted the following that we would like to bring to your attention:

Matter	KPMG comments
Related parties	As part of our audit procedures, we assess related party transactions and balances, and verify appropriate note disclosure in the financial statements. We did not identify significant related party transactions that have not been appropriately authorized and approved. Material transactions with related parties, all of which are in the normal course of operations, are adequately disclosed in the notes to the financial statements. Other than the COVID-19 subsidy revenue of \$14.4M for operations and \$3.6M for loan repayment (2020 - \$14.6M and \$2.3M, respectively), there were no significant, new, or unusual transactions.
Asset retirement obligations (ARO)	This is a future accounting pronouncement that will be effective for Exhibition Place's fiscal 2023 year-end. See also the new accounting standards in current developments on page 16 and Appendix on page 20. We understand that the City has requested Exhibition Place management to assess the guidance in this accounting standard and determine the impact that it will have on Exhibition Place's financial statements. The next step would be to put a plan in place to gather any required information and compile relevant site data such as a complete inventory of owned and leased assets, determining legal obligations for asset retirement, determining the likelihood of an ARO liability by asset, and quantifying the liabilities.

Appendices

Content

Appendix: Other required communications

Report	Engagement terms
Refer to the draft report attached to the draft financial statements.	A copy of the engagement letter and any subsequent amendments has been provided to City management.

Audit Quality in Canada	Representations of management
The reports available through the following links were published by the Canadian Public Accountability Board to inform audit committees and other stakeholders about the results of quality inspections conducted over the past year: • CPAB Audit Quality Insights Report: 2021 Interim Inspections Results • CPAB Audit Quality Insights Report: 2020 Annual Inspections Results	A copy of the management representation letter is available from management.

Required inquiries

Professional standards require that we obtain your views on risk of fraud and other matters. We made similar inquiries of management as part of our planning process.

- Fraud:
  - What are your views about fraud risks at the entity?
  - How do those charged with governance 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?
- Laws and Regulations:
  - Is the entity in compliance with laws and regulations?
- Significant Unusual Transactions:
  - Has the entity entered into any significant unusual transactions?

Appendix: Technology in the audit

We utilized technology to enhance the quality and effectiveness of the audit.

Technology	Areas of the audit where Advance Technology routines were used	Insights
Data Extraction & Analytics Tools	We used KPMG application software (DataShare) in order to directly and efficiently extract required data from the general ledger for data and analytic routines. We evaluated the completeness of the journal entry population through a roll-forward of the entire general ledger.	The general ledger roll consists of a summation of all automated and manual journal entries posted during the fiscal year and a comparison of the calculated amounts to the account balances as at and for the year ended December 31, 2021 as reported by management. The general ledger extraction was found to be complete and containing all entries recorded during the year. We were able to use this complete extraction for our testing of high-risk journal entries.
Journal Entry Analysis	We utilized Computer Assisted Audit Techniques ("CAATs") to analyze journal entries and apply certain criteria to identify potential high-risk journal entries for further testing.	We developed a set of high-risk criteria and applied the criteria to the entire population of journal entries. Journal entries containing high risk conditions were tested to ensure they were supported by proper documentation and followed the journal entry initiation and approval controls and process in place. We did not find any exceptions in our testing over journal entries.
DataSnipper	DataSnipper is a tool that uses optical character recognition and robotic process automation to automate vouching procedures.	We imported certain documents into the tool, which matched specified excel data to the corresponding documents, leaving an audit trail behind for review and assessment by our audit team members.
KPMG Clara for client collaboration	This tool is used to request and receive all audit requests from clients, including Exhibition Place.	This tool is web-based and allows the finance team to upload responses to our specific requests via secure link on the web portal.

Appendix: Current developments

Title	Details	Link
Public Sector Update – connection series	Public Sector Accounting Standards are evolving – Get a comprehensive update on the latest developments from our PSAB professionals. Learn about current changes to the standards, active projects and exposure drafts, and other items.	Contact your KPMG team representative to sign up for these webinars. [Public Sector Minute Link]

The following are upcoming changes that will be effective in future periods as they pertain to Public Sector Accounting Standards. We have provided an overview of what these standards are and what they mean to your financial reporting so that you may evaluate any impact to your future financial statements.

Standards	Summary and implications
Asset Retirement Obligations (see also the Appendix on this topic)	– The new standard is effective for fiscal years beginning on or after April 1, 2022. – 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. PSAS 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	– The new standard is effective for fiscal years beginning on or after April 1, 2023. – 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 transaction, 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.

Public Private Partnerships ("P3")	– PSAB has introduced Section PS3160, which includes new requirements for the recognition, measurement and classification of infrastructure procured through a public private partnership. The standard has an effective date of April 1, 2023 and may be applied retroactively or prospectively. – The standard notes 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 public sector entity recognizes 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, which represents fair value at the date of recognition with a liability of the same amount if one exists. Cost would be measured in reference to the public private partnership process and agreement, or by discounting the expected cash flows by a discount rate that reflects the time value of money and risks specific to the project.
Purchased Intangibles	– In October 2019, PSAB approved a proposal to allow public sector entities to recognize intangibles purchased through an exchange transaction. Practitioners are expected to use the definition of an asset, the general recognition criteria and the GAAP hierarchy to account for purchased intangibles. – PSAB has approved Public Sector Guideline 8 which allows recognition of intangibles purchased through an exchange transaction. Narrow-scope amendments were made to Section PS 1000 Financial statement concepts to remove prohibition on recognition of intangibles purchased through exchange transactions and PS 1201 Financial statement presentation to remove the requirement to disclose that purchased intangibles are not recognized. – The effective date is April 1, 2023 with early adoption permitted. Application may be retroactive or prospective.

Appendix: Upcoming changes to auditing standards

The following changes to auditing standards applicable to our 2022 audit are listed below.

Standard	Key observations
Revised CAS 315, *Identifying and Assessing the Risks of Material Misstatement*	Revised CAS 315, *Identifying and Assessing the Risks of Material Misstatement* has been released and is effective for audits of financial statements for periods beginning on or after December 15, 2021. The standard has been significantly revised, reorganized and enhanced to require a more robust risk identification and assessment in order to promote better responses to the identified risks. Key changes include: – Enhanced requirements relating to exercising professional skepticism – Distinguishing the nature of, and clarifying the extent of, work needed for indirect and direct controls – Clarification of which controls need to be identified for the purpose of evaluating the design and implementation of controls – Introduction of scalability – Incorporation of considerations for using automated tools and techniques – New and revised concepts and definitions related to identification and assessment of risk – Strengthened documentation requirements CPA Canada plans to publish a Client Briefing document in early 2022 to help you better understand the changes you can expect on your 2022 audit.

Appendix: Audit and assurance insights

Our latest thinking on the issues that matter most to audit committees, Boards and Management.

Featured insight	Summary	Reference
Accelerate 2022	The key issues driving the audit committee agenda in 2022.	Learn more
Audit Committee Guide – Canadian Edition	A practical guide providing insight into current challenges and leading practices shaping audit committee effectiveness in Canada.	Learn more
Unleashing the positive in net zero	Real solutions for a sustainable and responsible future.	Learn more
KPMG Audit & Assurance Insights	Curated research and insights for audit committees and boards.	Learn more
Board Leadership Centre	Leading insights to help board members maximize boardroom opportunities.	Learn more
KPMG Climate Change Financial Reporting Resource Centre	Our climate change resource centre provides insights to help you identify the potential financial statement impacts to your business.	Learn more
The business implications of coronavirus (COVID 19)	Resources to help you understand your exposure to COVID-19, and more importantly, position your business to be resilient in the face of this and the next global threat.	Learn more
	KPMG Global IFRS Institute - COVID-19 financial reporting resource center.	Learn more
IFRS Breaking News	A monthly Canadian newsletter that provides the latest insights on international financial reporting standards and IASB activities.	Learn more
Momentum	A quarterly Canadian newsletter which provides a snapshot of KPMG's latest thought leadership, audit and assurance insights and information on upcoming and past audit events – keeping management and board members abreast on current issues and emerging challenges within audit.	Sign-up now
Current Developments	Series of quarterly publications for Canadian businesses including Spotlight on IFRS, Canadian Securities & Auditing Matters and US Outlook reports.	Learn more
KPMG Learning Academy	Technical accounting and finance courses designed to arm you with leading-edge skills needed in today's disruptive environment.	Learn more

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Why Audit Committees should know about Asset Retirement Obligations

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Municipalities have evolved significantly over the last two decades and this evolution has escalated over the last two years due to the huge push towards digital transformation. Municipalities have come to a refreshed realization about the dynamic change it needs from their citizens resulting in a push towards a citizen-centric approach to defining their goals and objectives.

With all this change, the citizens are looking for new and improved ways to obtain information from the municipalities and public sector entities generally. They are looking for information that is timely, accurate and accessible. For instance, more and more municipalities are moving towards quarterly financial reporting to provide more timely information to stakeholders.

The finance function within municipalities tend to focus a large portion of their resources on their budget-setting process each year, relative to financial reporting. This budget sets out the municipality's operating and capital spending plan for the next year, leading to the determination of the necessary tax levy to support the planned spend. It is necessarily a cash-based document, which leads to difficulty in comparing it to a municipality's financial results, which are prepared on a basis prescribed by the Chartered Professional Accountants Canada. The annual financial statements are presented on an accrual basis in accordance with Public Sector Accounting Standards (PSAS). This disconnect between the cash basis and accrual basis often makes it difficult for 'Those Charged With Governance' (TCWG) to fully understand the actual financial results since relatively more resources are deployed towards the creation of the budget than the presentation of the financial results. While there are quite a few intersections between the budget-based reporting and PSAS reporting, there are many differences that can come in the way of effective municipal financial management and oversight.

Please note that the discussion in this paper is relevant for all public sector entities that report their financial results in accordance with PSAS. While the specific examples in this paper focus on municipalities, the same implications can be applied to other entities with slight modification to incorporate the differences in operations in the various types of public sector entities.

With that in mind, let's talk about a new reporting standard which is required to be implemented by public sector entities for years ending on or after April 1, 2022 and why it is important for TCWG to understand the implications of this new standard. This standard pertains to Asset Retirement Obligations (ARO) and requires public sector entities to set up a liability related to the legal obligation for retiring a tangible capital asset. The assets that fall into this standard are the ones that are controlled by the public sector entity and includes leased assets. This standard has far-reaching impacts for municipalities and requires proper attention from TCWG, in order to exercise appropriate oversight over the financial reporting process. We have highlighted some key items here:

(a) Completeness of liabilities
(b) Legal obligations
(c) Completeness of assets
(d) Technical expertise
(e) Financing repercussions
(f) Environmental Social Governance (ESG) implications

Let's talk about these one by one!

a. Completeness of liabilities

In many cases, the liability associated with AROs has not been recorded within the financial records of the public sector entities which means that these entities are underreporting their obligations. It is possible that certain public sector entities might have some of these obligations included within their legal obligations however it is unclear how these are being tracked and whether the process used to determine the magnitude of these legal obligations is accurate.

Not only is it important to have accurate and complete information for the measurement and recognition of these liabilities for financial reporting purposes, but the same information is also equally important for financial planning and for effective financial management of the municipalities.

One of the tools used by municipalities in order to perform long term financial planning is through reserves and reserve funds to ensure they have sufficient funds set aside for future needs. If a municipality does not have a clear understanding of their ARO liability, it would hinder their ability to assess the adequacy of their reserve funds. Cash flow management would also be impacted due to the potential unplanned outflow in any given year.

b. Legal obligations

Next, let’s talk about legal obligations. It is important to understand that the obligation related to the ARO is a legal obligation. However, unlike some of the traditional legal obligations, where there might be uncertainty around the outcome of the legal item, there is no uncertainty related to the existence of the future obligation related to an ARO. This means that the future settlement is guaranteed for an ARO and the uncertainty in this situation is limited to the quantification or the amount of the future settlement.

Not getting a good handle on the ARO liability also increases the risk of negative legal implications for the municipality in the future. As an example, if there is a contaminated site that requires a municipality to perform clean up to ensure the safety of the residents, but this contamination is not rectified in a timely and reasonable manner as required by environmental regulations. This could result in severe legal implications for the municipality due to the hazardous nature of these materials and potential negative health impact on the residents.

The new ARO reporting standard also includes the concept of promissory estoppel as part of the legal liability assessment. For your convenience, we have included the definition of promissory estoppel in the glossary at the end of this document.

The key point that is important to emphasize is that it would be important to engage a legal expert as part of the ARO implementation team as this assessment might be outside the expertise of the core finance team members.

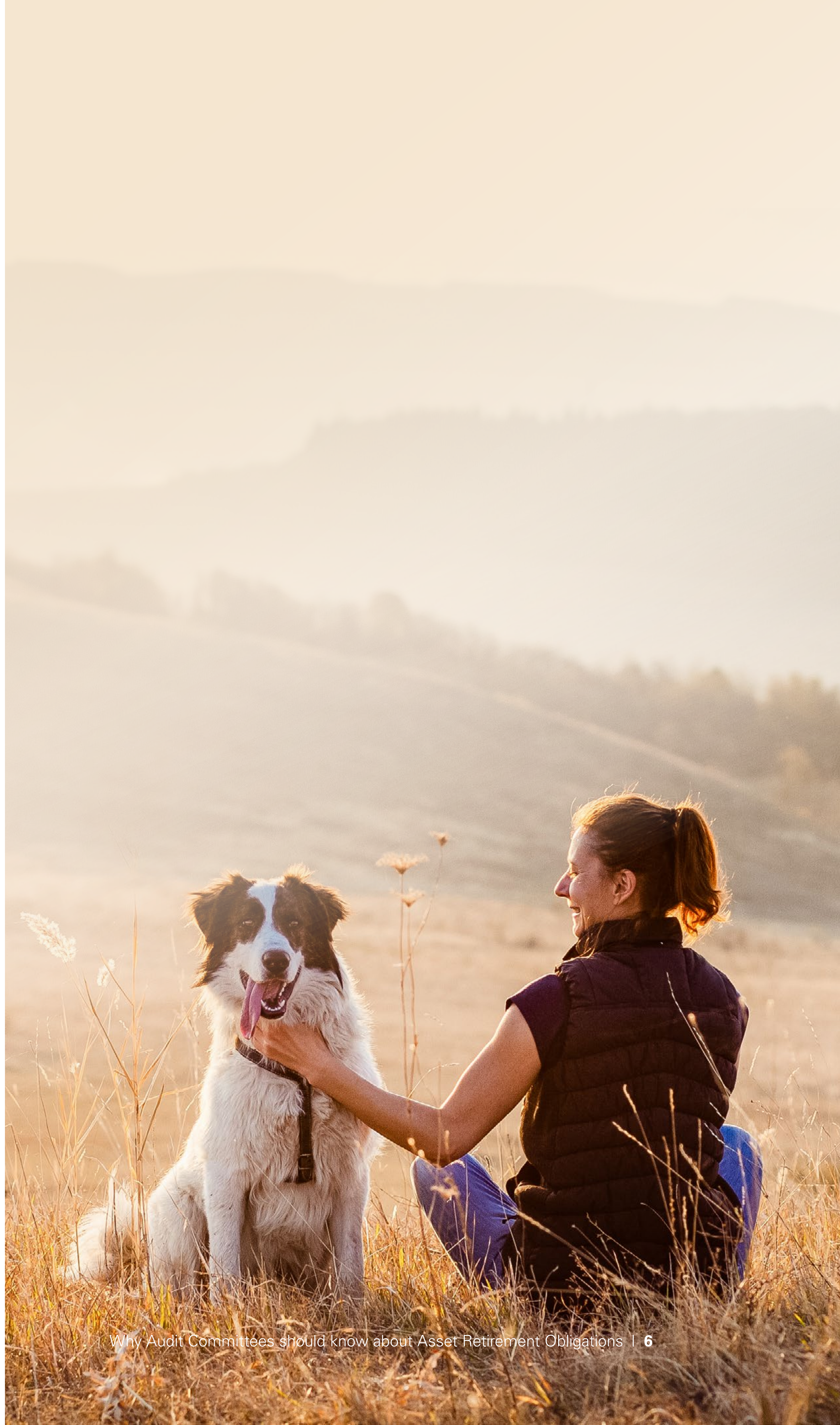
c. Completeness of assets

When Canadian municipalities first began reporting their tangible capital assets as a component of their balance sheets back in 1999, it was apparent that many municipalities did not have good historical data on the assets that they owned at that time and consequently many still do not have a complete listing of owned assets. A comprehensive approach to asset management brings numerous benefits to local and regional governments and assists them in being able to demonstrate that taxpayers get good value from each capital asset they fund, in part or in whole.

This is a contributing factor as to why there are regulatory requirements for good asset management practices. For example, the Federal Gas Tax Agreement requires municipalities to demonstrate a strong asset management system. In absence of a well-thought-out asset management plan, local municipalities could put at risk the operational effectiveness of their assets, public health and safety and overall public confidence in the local government. A solid asset management approach helps to ensure reliability of the services offered by a local government and thus instill more confidence from the public.

Asset management itself is quite a broad topic of discussion for municipalities, perhaps the above description provides an understanding of why there is so much emphasis placed on good asset management. As important as it already was to have a complete listing of tangible capital assets in order to develop a reasonable asset management plan, it has become even more so with the implementation of financial reporting standards for AROs. This due to the fact that AROs are based on identifiable tangible capital assets controlled by the Entity. If the asset listing is not complete or not up to date, any obligations relating to assets not being reported would also not be captured. If items are missed in the scoping and measurement of AROs, this results in a significant risk for the municipalities where the corresponding liabilities will be incomplete. There might be other consequences of missing these liabilities for municipalities depending on the nature and extent of error such as cash-flow management, environmental and social implications.

The ARO standard does not require entities to assess their overall asset management approach for reasonableness. The ARO standard also does not require entities to undertake an asset management exercise to make sure they have a complete inventory of all of their assets. However, it is quite clear that the entities who have an accurate and complete listing of their assets through a well-thought-out asset management plan are the ones who will be in the best position to ensure completeness of their AROs.



d. Technical expertise

Another matter to consider and assess is the quality of the information that the entity has regarding their assets. How well does the entity understand its assets including the nature and components of its assets? For the finance team to scope and measure the ARO associated with different assets, they would need clear guidance from subject matter experts that understand the technical aspect of this determination.

Finance teams would likely have the requisite expertise relating to the cost and fair value of these assets but may not be as aware of the legal, environmental, and / or other obligations attached to these assets. The knowledge of subject matter experts will be to assist the finance team in this area.

In addition to legal experts, other experts on which the exercise may depend upon include individuals from the operations team, mechanical and engineering teams, etc.

It would be important to have a discussion with the finance team to identify which subject matter experts are considered necessary based on their initial assessment in order to make optimal resource allocations. It would also be important to note that these needs could change as the implementation project matures.

e. Financing repercussions

Even though not directly related to ARO, financing repercussions should also be front of mind with overall asset management, particularly when planning for asset replacement / remediation / maintenance. In different provinces in Canada, there are restrictions on the amount of borrowing for local municipalities. In Ontario, for instance, long-term borrowing is restricted to capital investments and is also subject to a prescribed maximum level based on a preset formula.

Local municipalities use debt to help finance large capital projects. Local municipalities conduct long-term financial planning through the adoption of a multi-year capital plan and a long-term fiscal plan that would typically consider the amount and timing of debt necessary to support the planned expenditures over the term of Council. It also becomes important to understand the useful life of the asset in order to match the cost to the period over which the benefits are received. This provides more affordable financing by matching the repayment term to the economic useful life of the project, instead of funding the entire cost from current revenues.

In recent years, we have noted the trend of the issuance of green bonds, with the province of Ontario reaching a whopping $10.75 billion in green bonds in 2021. Other local municipalities are following suit and this move is expected to continue. It would be important to have a good grasp on the asset management plans before these green bonds are attached to environmentally friendly infrastructure capital projects. Talking about green bonds, let's move into other ESG considerations.

f. ESG Implications

It is quite interesting that the concept of ARO touches all three aspects of the ESG spectrum i.e., environmental, social and governance. Physical contamination caused by hazardous materials such as asbestos or the toxins and leachate from landfills are all contributors towards damaging the environment.

Inappropriate or sub-optimal treatment of these hazardous materials can have significant health detriments which becomes a social responsibility issue whereby the expectation is that public sector entities, especially municipalities would ensure appropriate level of remediation for these hazardous items. The heightened fiduciary responsibility in the public sector environment especially with the elected officials with the municipalities creates a huge need for an appropriate level of governance in place.

The ESG implications for ARO have gained a lot of traction in recent years. These discussions have become more important now as public sector entities work towards the implementation of this new standard. While it is important to embrace ESG into our strategic planning, it will be critical to ensure that this planning is comprehensive and well thought out. As daunting as this task can seem, the key is to have a structured approach to map out what is relevant for the organization and to design a plan to tackle these implications.

In conclusion, while the ARO standard implementation may seem like any other accounting standard implementation, it has far reaching implications from a municipal operational and governance perspective requiring consideration and input from the organization as a whole, not just its finance team. It is therefore critical to take the time to understand these implications and design a plan to address them in a meaningful manner.

We would be more than happy to continue this discussion with you. We are currently running customized sessions for different entities to help them understand these various implications of AROs and how to best address them.

Special thanks to Kevin Travers, Partner KPMG Enterprise and Bailey Church, Partner Accounting Advisory Services for their contributions to this publication.

Contact us

Maria Khoushnood
Partner, KPMG Enterprise
KPMG in Canada
416-228-7082
mkhoushnood@kpmg.ca

Kevin Travers
Partner, KPMG Enterprise
KPMG in Canada
416-228-7004
ktravers@kpmg.ca

home.kpmg/ca

Be social with **@KPMGCanada**

Glossary

Public Sector

Public sector refers to governments, government components, government organizations and partnerships. Each of these entities is a "public sector entity". A government component is an integral part of government, such as a department, ministry or fund. It is not a separate entity with the power to contract in its own name and that can sue and be sued. A government organization is any organization controlled by a government that is a separate entity with the power to contract in its own name and that can sue and be sued. Public sector organizations have a higher accountability to the taxpayer – above and beyond the traditional fiduciary duty.

Promissory estoppel

The elements of a promissory estoppel claim are "(1) a promise clear and unambiguous in its terms; (2) reliance by the party to whom the promise is made; (3) [the] reliance must be both reasonable and foreseeable; and (4) the party asserting the estoppel must be injured by his reliance."

Appendix: Considerations for Environment, Social and Governance (ESG)

When thinking about ESG, the following are the two key considerations:

Financial Reporting Impacts

- How a company reflects the impacts of climate-related matters in the financial statements will depend on its specific facts and circumstances, including the nature and extent of those impacts on the company.
- IFRS Standards do not refer explicitly to climate-related risks or climate-related matters, but they implicitly require relevant disclosures in the financial statements when climate-related matters considered in preparing the financial statements are material.
- Companies are required to consider materiality carefully in deciding what information to provide as information may be material even though there is no current-period financial impact.

Accounting impacts from ESG-related risks and opportunities on key areas of judgement and estimates that may be relevant will vary by industry.

Sustainability Reporting

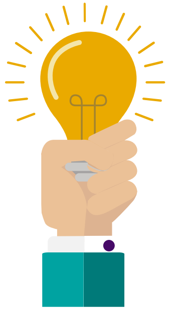
- ESG-related information is frequently disclosed outside of traditional financial statements whether in be in separate sustainability reports but also could be within the MD&A and/or AIF
- Such information can be in the form of key metrics as identified by management or specific qualitative information around key risks and opportunities

Common voluntary disclosure frameworks used are Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) by industry, and the Taskforce on Climate-Related Financial Disclosures (TCFD).

How might climate-related risks impact the financial statements?

The audit committee's deep understanding of internal control and financial reporting puts it in a good position to challenge management to develop systems and processes for ESG risk and opportunity identification, to create resilient strategies to manage these risks, to develop metrics, processes and controls around data collection and ESG reporting.

The following are ten questions as a starting point to assess the impact on financial statements.



10 questions to start impact assessment of climate-related risks to the financial statements

For further insights, please refer to KPMG publication "10 questions for audit committees" at the KPMG Climate Change Resource Centre.

01 Has your company made a net-zero commitment?

02 Does your company have polluting assets?

03 Is your company exposed to carbon-related regulation?

04 What about your inventory and production costs?

05 Does your company take part in an emissions scheme?

06 Does your company borrow funds?

07 Is your company a provider of finance?

08 What about your staff benefits?

09 What about your cash flow forecasts?

10 What about your disclosures?

The Importance of ESG

Public Commitment

Increased public commitments to global initiatives and announcements relating to climate change, nature, sustainable development goals, impact and social issues.

Access to capital

Investors, lenders and underwriters increasingly factor in ESG considerations when making investment decisions, offer sustainability-linked products and require sustainability-related information from customers and clients.

Regulatory developments

ESG-related compliance costs and disclosure requirements continue to evolve, as securities commissions, prudential supervisors, stock exchanges and governments tighten the rules.

Reporting standards

Measurement and reporting of ESG-related information is maturing rapidly, as investor-centric disclosure standards are making headway (e.g. ISSB, TCFD, SASB).

Societal pressure

Stakeholders increasingly scrutinize companies' ESG performance and transparency affecting project approval, brand acceptance and consumer demand.

Climate change

Widespread recognition that climate change is a material financial risk – measuring and managing climate risks (and opportunities) is maturing and considered critical to financial risk management.

Enhanced risk management and investment returns

ESG integration has become an investment norm. 75% of institutional investors now consider ESG factors to be "material" to their investment analysis.

Workforce of the future

ESG has become a key factor in attracting and retaining top talent, as employees are seeking purpose from their work.

Emerging Reporting Requirements by Regulator

There are a number of reporting standards which will or may impact Canadian companies and could be effective as early as December 2022. They vary in scope and with respect to external assurance requirements.

	International Sustainability Standards Board (ISSB)	Securities Exchange Commission (SEC)	Canadian Securities Administrators (CSA)
General Sustainability–related Information	**IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*** Sets the foundation with: - general features of reporting, including materiality - A structure across the four areas of governance, strategy, risk management and metrics and targets - Practical guidance, including presentation of information	No general sustainability guidance issued.	No general sustainability guidance issued.
Climate-related Information	**IFRS S2 *Climate-related disclosures*** Builds on the content areas with additional guidance on: - disclosures of risks, climate transition plans and scenario analysis; and - general and industry-specific metrics	**SEC Release Nos 33-11042 and 34-94478 *The Enhancement and Standardization of Climate-related Disclosures for investors*** Addresses climate-related information through: - Specified metrics and disclosures within the FS; and - Separate climate-related disclosures within the Annual Report or Registration Statement**	**National Instrument 51-107 *Disclosure of Climate-related Matters*** Addresses climate-related information within the annual information form (AIF) or management's discussion and analysis (MD&A)
Specific Sustainability-related Information	**Additional standards expected to be issued in the future**: - Industry-specific guidance; and - Other topics – e.g. biodiversity	**Additional standards issued or expected to be issued in the future:** - Cyber security; - Human capital; and - Board diversity	No additional standards issued or expected to be issued (yet)

**Third party assurance required over Scope 1 and 2 emissions, shifting from limited to reasonable over time

Role of the Audit Committee

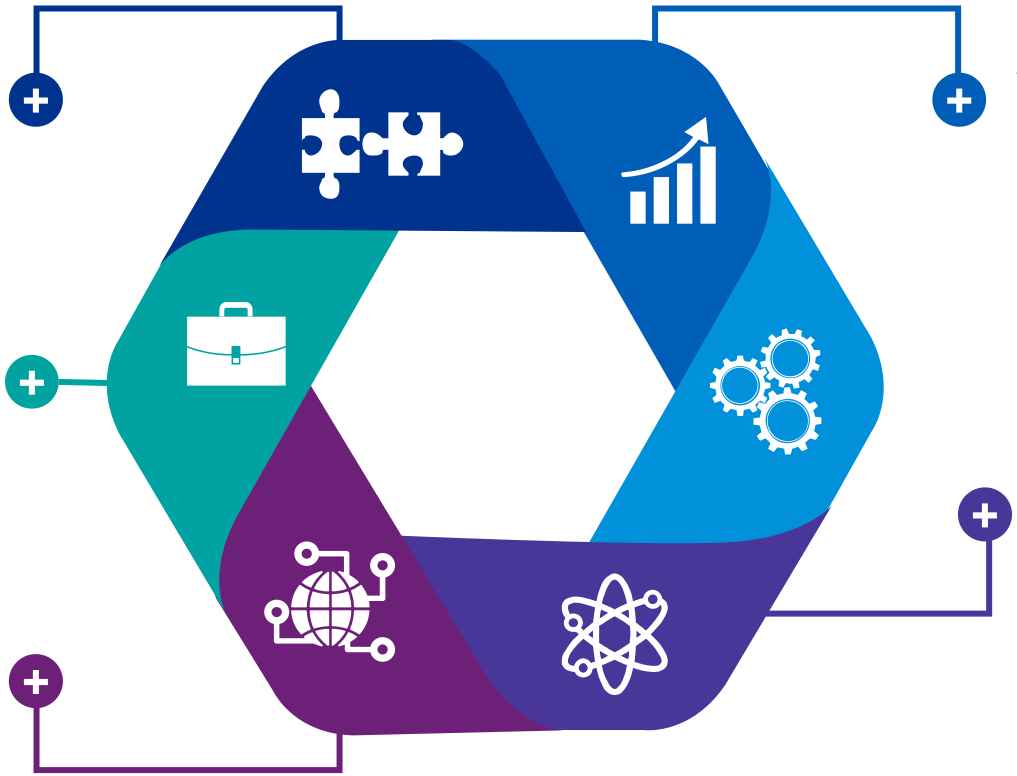
The Audit Committee will need to be involved in overseeing the development of policies, systems, processes, internal controls, governance and assurance for ESG data and reporting similar to that which is in place for collecting and disclosing financial information.

Questions for Management

What are the ESG topics that align to company's and stakeholders' priorities?
Audit committees should understand stakeholders' priorities and the company's material ESG issues, particularly, where those two topics overlap.

Is the company currently reporting on its ESG efforts, and where?
The data's importance to a company's ESG strategy, including financial materiality, should align with corresponding regulations and levels of risk associated with the data. This should determine the reporting method.

Are there established processes and controls in place for data collection and reporting?
Collecting data in a consistent method is important. In some cases, there is an established standard that is accepted by almost all investor groups. For example, the Greenhouse Gas Protocol is widely recognized as a way to report on emissions.



What level of assurance is the company getting on ESG metrics? What is being assured, by whom, and what is the value of the assurance?
It is critical for companies to begin to identify their priorities before pressure from customers, shareholders, and others push to accelerate the company's timeline. Audit committees are best positioned to understand which metrics merit assurance.

How should the company think about value creation and competitors when engaging on ESG?
Audit committees should take steps to understand the business and competitive environment regarding ESG strategy and reporting. Developing a clear ESG strategy, along with a standardized reporting process can set a company apart from its competition, as investors, customers, and other stakeholders increase their scrutiny.

KPMG Insights

Right click on each hyperlink to access the report.

Thought leadership

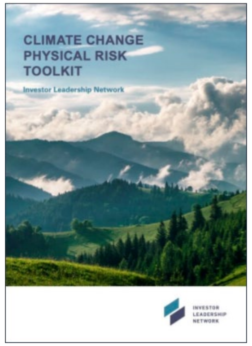
At KPMG we invest heavily in deepening our knowledge of ESG key trends, technical issues and differences among sectors. This ensures we remain at the forefront of our field.

Through our extensive Sustainability, ESG and Responsible Investing experience, we're proud of our contributions to global industry best practice.

Sustainable Investing Fast-forwarding its evolution (2020)

Frontiers in Finance (2020)

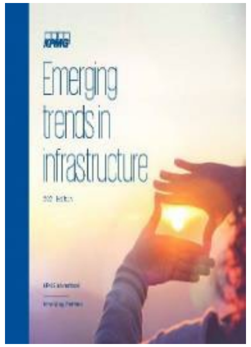
Climate Change Physical Risk Toolkit (2021)



Supporting Growth and Ensuring Care (2020)

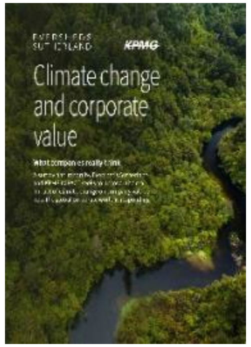
Business and the environment (2020)

Emerging Trends in Infrastructure 2021 Edition (2021)

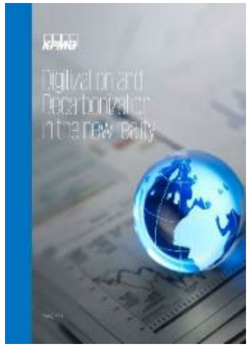


You can't go green without blue (2021)

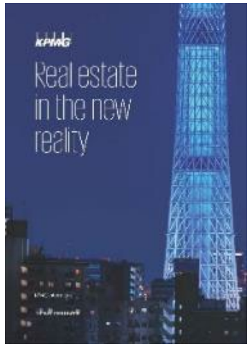
Climate change and corporate value (2020)



Digitization and decarbonization in the new reality (2020)



Real Estate in the New Reality (2020)



SEC proposes climate reporting and assurance rules (2021)

An audit committee lens on ESG reporting (2021)

Towards Net Zero (2020)

The time has come (2020)

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