The City of Toronto

Audit Findings Report
for the year ended December 31, 2021

KPMG LLP

Licensed Public Accountants

Prepared on May 31, 2022 for

Presentation on July 11, 2022

kpmg.ca/audit

KPMG

Table of contents

KPMG contacts

The contacts at KPMG in connection with this report are:

KEVIN TRAVERS

Lead Audit Engagement Partner

Tel: (416) 228-7004

Email: ktravers@kpmg.ca

PAUL SIMONETTA

Executive Relationship Partner

Tel: (416) 228-7287

Email: psimonetta@kpmg.ca

MARIA KHOUSHNOOD

Project Management Partner

Tel: (416) 228-7082

Email: mkhoushnood@kpmg.ca

IAN JEFFREYS

Engagement Quality Control Review Partner

Tel: (519) 660-2137

Email: ijeffreys@kpmg.ca

KASHIF KHAN

Partner, Information Risk Management (IRM)

Tel: (416) 777-8149

Email: kakhan@kpmg.ca

GREG WINSTON

Partner, Actuarial Team

Tel: (416) 777-8862

Email: gregwinston@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.

KPMG contacts, (continued)

Zac Brown

Audit Manager

Tel: (416) 791-2076

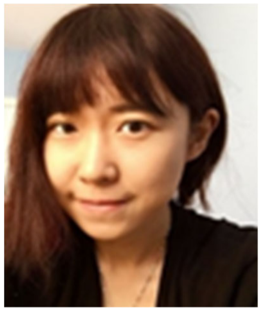
zacbrown@kpmg.ca

HASSAN KHALID

Senior Manager, IRM

Tel: (416) 791-2193

hassankhalid@kpmg.ca



SUSAN ZHOU

Lead Senior, Financial Statement Audit

Tel: (416) 549-7887

susanzhou@kpmg.ca

ANH TU LE

Executive Director, Actuarial Team

Tel: (647) 777-5352

ale@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

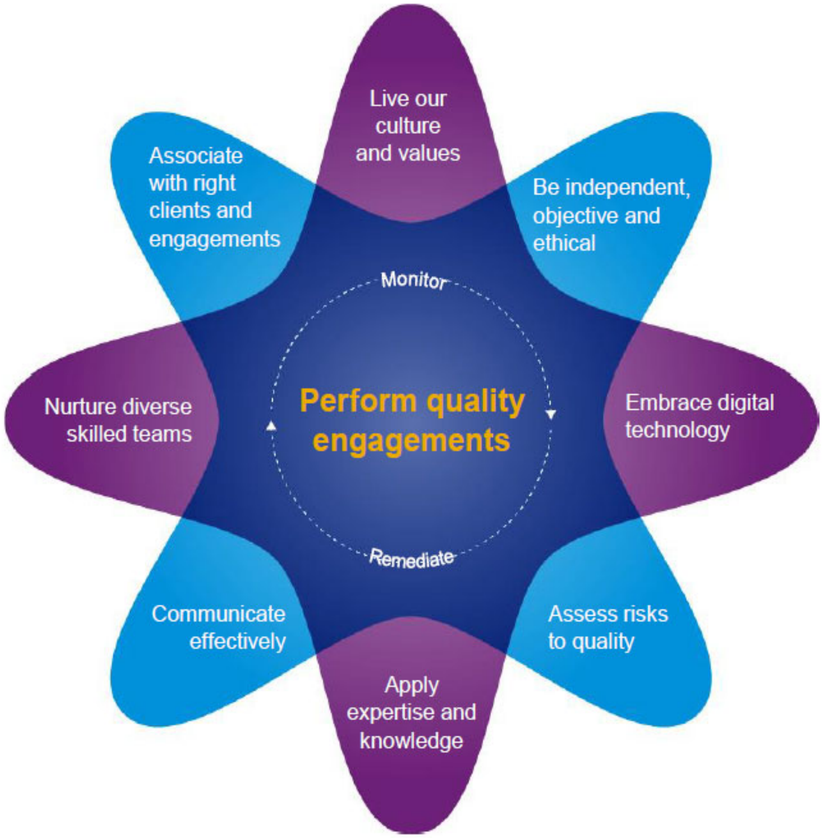
Quality essentially means doing the right thing and remains our highest priority. Our **Global Quality Framework** outlines how we deliver quality and how every partner and staff member contributes to its delivery.

'**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.**



Visit our **Resources** page for more information.

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 audit committee, in your review of the results of our audit of the consolidated financial statements as at and for the period ended December 31, 2021.

Status of the audit

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

- Completing our discussions with the audit committee
- Obtaining evidence of the Council's approval of the financial statements.
- Receipt of the signed management representation letter and discussion regarding subsequent events
- Completion of our audit quality control review process

We will update the audit committee, 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 attached to the draft financial statements, will be dated upon the completion of any remaining procedures.

Significant changes from the audit plan

There were no significant changes to our audit plan which was originally communicated to you in the audit planning report. Included in this report are the more significant findings from the audit, that we have determined appropriate to communicate to you.

Going concern

No matters to report.

Significant risks and other significant matters

There are no significant findings to communicate related to significant risks or other significant matters.

[1] This report to the audit committee is intended solely for the information and use of Management, the audit committee, and the Board of Directors and should not be used for any other purpose or 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.

Audit highlights (continued)

Uncorrected and corrected audit misstatements

Professional standards require that we request of management and the audit committee that all identified audit misstatements be corrected. We have already made this request of management.

Refer to page 13 of this report for uncorrected and corrected audit differences.

Control deficiencies

Our audit approach was substantive where we did not place reliance on controls. Our audit opinion is based on the results of these substantive procedures. We did not identify any control deficiencies that we determined to be significant deficiencies in internal control over financial reporting. We have identified some additional opportunities for process improvement at the City. We are currently in the process of providing these to the City Management for their consideration.

Significant accounting policies and practices

The significant accounting policies noted in the consolidated financial statements of the City are in accordance with the Public Sector Accounting Standards. There have been no initial selections of, or changes to, significant accounting policies and practices to bring to your attention.

Audit risks and results

We highlight our significant findings in respect of **significant risks** as identified in our discussion with you in the Audit Plan, as well as any additional significant risks identified.

Significant risk	New or changed?	Estimate?
Fraudulent revenue recognition: There is a presumed risk of material misstatement due to fraud. We have considered the type and complexity of revenue transactions, and the perceived opportunities and incentives to fraudulently misstate revenue for the Entity and its subsidiaries. The fraud risk resides within overstatement of revenue through posting manual journal entries and other adjustments relating to deferred revenue (obligatory reserve funds). **Management override of controls:** There is a presumed risk of material misstatement due to fraud.	No	No

Our response

– To address the risk of fraudulent revenue recognition and fraud related to management override of controls reported in the audit planning report, we performed an extensive amount of testing on the journal entry process including the following:
    - we evaluated the design and implementation of selected relevant controls;
    - we tested journal entries that met specific criteria designed as part of our audit plan;
    - we performed journal entry testing focussed on manual journal entries for revenue and deferred revenue transactions. This criterion is based on areas and accounts that are susceptible to manipulation through management override due to their manual nature; and,
    - we used computer assisted audit techniques to identify any unusual journal entries.

Significant findings

– We did not identify and issues or concerns regarding fraud pertaining to revenue recognition and management override of controls.

Audit risks and results (continued)

Significant risk	New or changed?	Estimate?
Revenues	No	No

Our response

The City recognizes revenue from the different streams including property and taxation from other governments, government transfers, user charges, municipal land transfer tax, development charges, rent and concessions, equity pick up from government business enterprises, investment income, and other. Management follows the revenue recognition policies reported in the financial statements note 1 to recognize revenue in accordance with PSAS.

Deferred revenue:

– KPMG substantively tested revenues (both recognized and amounts held as deferred at year end) via samples. We obtained and reviewed the continuity for deferred revenue prepared by management. We also recalculated management's calculation of deferred revenue – obligatory reserve funds as at year-end. We also selected a sample of the increases (cash receipts) and decreases (revenue recognition) for deferred revenue during the current year to ensure appropriate revenue recognition.

Government Transfers:

– We obtained and vouched revenue to funding agreements from the federal and provincial governments including the amounts received as part of the Safe Restart Program.
– The City received funding as part of the Safe Restart Program and Social Services Relief from federal and provincial governments. The amount for 2021 was appropriately recognized as revenue.
– To address the inherent risk of error in revenue recognition, we substantively tested revenues and deferred revenue, including cut-off procedures.

Significant findings

– We did not note any significant issues as a result of audit procedures related to other categories of revenue.
– Based on the audit work performed, we did not note any material misstatements related to revenue recognized for the City. The disclosures made by the City are in accordance with the accounting standards.
– Management representation letter includes one corrected audit adjustment related to revenues for Childcare Services in the amount of $43 million. This adjustment reflects the activity for the fourth quarter for advances provided to childcare centres.

Audit risks and results (continued)

We highlight our significant findings in respect of **other areas of focus** as identified in our discussion with you in the Audit Plan, as well as any additional areas of focus identified.

Area of Focus	New or changed?	Estimate?
Employee Benefits Liabilities Employee future benefits represent a liability computed by management's actuarial experts. As the employee future benefits liabilities are significant and complex estimates, KPMG actuarial specialists were involved in completing the audit procedures.	No	Yes. Estimation uncertainty exists related to the likelihood and measurement of contingent liability. KPMG audit team engaged KPMG Actuarial specialist team to assist in auditing the data, method and assumptions related to this estimate.

Our response

- We assessed the participant data supplied by management to the Actuary for completeness and accuracy.
- We obtained the actuarial valuation report and engaged our KPMG actuarial specialist team to audit the method and assumptions applied in the valuation.
- We evaluated the discount rate in comparison with rates issued by the Canadian Institute of Actuaries ("CIA") and KPMG LLP.
- We assessed the qualifications, competence and objectivity of the actuary as required by the Canadian auditing standards.
- We assessed the disclosures in the financial statements against the requirements of the PSAS.

Significant findings

- Based on our review of the memo prepared by the Actuary, we noted that method applied for the estimate is acceptable per CIA and PSAS 3250 Retirement Benefits.
- KPMG actuarial specialist team assessed the key assumptions used by the Actuary in light of the City's financial results. KPMG specialists noted that the significant assumptions stayed consistent compared to the previous valuation report.
- We note that the discount rate used by the Actuary is a key assumption. KPMG actuarial specialist team evaluated the discount rate used by the actuary against the discount rate curve issued by different reliable sources. Based on the results of this evaluation, we concluded that the discount rate used is reasonable.
- The disclosures included in the financial statements are in accordance with the requirements of the PSAS.
- Based on the audit work performed, we did not note any issues related to the calculation of the City's Employee Benefits Liabilities as at December 31, 2021.

Audit risks and results (continued)

Area of Focus	New or changed?	Estimate?
Tangible Capital Assets Tangible capital assets present the biggest non-financial asset for the City. There is a risk of material misstatement related to the existence and accuracy of tangible capital assets and accuracy of timing of revenue recognition, particularly related to funds intended for tangible capital assets.	No	Yes, useful lives used for amortization. Risk of material misstatement due to estimation uncertainty is remote.

Our response

- Performed testing over manual and automated controls related to recording costs to the relevant capital projects.
- Performed substantive test of details over additions and disposals using a representative sample.
- Obtained amortization policy and assessed reasonableness of estimated useful lives in use and to address the requirements of new CAS540, Auditing Accounting Estimates and Related Disclosure related to useful lives.
- Reviewed assets under construction to ensure amounts are properly transferred to correct capital asset classes and amortization commences on a timely basis.
- Obtained an understanding of asset write-downs during the year and the rationale behind these write-downs.
- Reviewed financial statement note disclosure in line with the PSAS.

Significant findings

- Based on testing performed we noted that the process around the transfer of assets under construction to completed tangible capital assets upon substantial completion can be improved and done on a more timely basis.
- We identified errors in the assets under construction (“AUC”) category where the substantially completed assets were not transferred out of AUC in a timely manner. This issue was identified in the prior year and noted in the significant findings. This results in the timing of the commencement of amortization being delayed as well as an overstatement of the assets under construction caption and an understatement of the relevant in-service asset categories. We brought the matter to the attention of management and asked management to adjust for the identified error. We performed additional audit procedures on the completeness of transfers from AUC and did not identify any other errors. As a result, management has corrected the identified error whereby $223 million of AUC were reclassified into completed tangible capital assets categories. Total tangible capital assets amount did not require an adjustment as this adjustment was a reclassification between the two categories included within tangible capital assets. The impact on the amortization expense was not significant.
- Based on the audit work performed, there were no other items of significance to be reported.

Audit risks and results (continued)

Area of Focus	New or changed?	Estimate?
Contingent liabilities PSAS 3300 Contingent Liabilities requires that the City recognize a liability when "it is likely that a future event will confirm that a liability has been incurred at the date of the financial statements; and the amount can be reasonably estimated." At any point in time, the City is subject to a number of matters which could potentially result in the determination of a contingent liability as defined above, including, but not limited to matters such as legal claims, etc. The City has disclosed the provision for property and liability claims in the financial statements.	No	Estimation uncertainty exists related to the likelihood and measurement of contingent liability. KPMG audit team engaged KPMG Actuarial specialist team to assist in auditing the data, method and assumptions related to the provisions for property and liability claims.

Our response

– We held discussions with the City to understand the process employed to determine the estimates for the liabilities for property and liability claims and legal matters.
– We obtained an understanding of the methodologies applied to compute the estimate, data involved, and assumptions applied.
– We engaged our KPMG Actuarial specialist team to audit the data, method and assumptions related to provision for property and liability claims due to high complexity.
– We obtained and evaluated the City's assessments and claims listing that are used to develop and record these estimated liabilities.
– We obtained a legal confirmation from the internal legal counsel and evaluated the assessments made by internal legal counsel on the pending legal matters in terms of determination of likelihood and measurability. We also obtained external legal confirmations as necessary.

Significant findings

– Due to uncertainty related to the legal matters, it is possible that the final amounts recorded for these liabilities may change, however the amounts currently recorded represent management's best estimates of exposure given the information presently available.
– KPMG Actuarial specialist team did not note any material misstatements in the method, data, and assumptions used by the City for property and liability claims provision. KPMG Actuarial specialist team noted some process improvement opportunities related to claims processing at the City and these have been shared with management in a separate document.
– We did not note any material misstatements related to the contingent liabilities reported by the City.

Uncorrected and corrected audit misstatements

Audit misstatements include presentation and disclosure misstatements, including omissions.

Uncorrected audit misstatements

We did not identify misstatements that remain uncorrected.

Corrected audit misstatements

The management representation letter includes all misstatements identified as a result of the audit, communicated to management and subsequently corrected in the financial statements.

Financial statement presentation and disclosure

Misstatements, including omissions, if any, related to presentation and disclosure items are in the management representation letter.

We also highlight the following:

Financial statement presentation - form, arrangement, and content	The form, arrangement and content of the financial statements is adequate.
Significant qualitative aspects of financial statement presentation and disclosure	We did not note any material disclosure omissions in the financial statements.

Appendices

Content

Appendix 1: Other required communications

Report	Engagement terms
The conclusion of our audit is set out in our draft auditors' report attached to the draft financial statements.	A copy of the engagement letter and any subsequent amendments has been provided to the audit committee.
Report to the Audit Committee and Council	**Representations of management**
This report.	We will obtain from management certain representations at the completion of the audit.
Audit Quality in Canada	**Control deficiencies**
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 Visit our **Audit Quality Resources page** for more information including access to our **Transparency report**	None noted.

Appendix 2: 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	– 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. 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.
Financial Instruments and Foreign Currency Translation	– The accounting standards, PS3450 *Financial Instruments*, PS2601 *Foreign Currency Translation*, PS1201 *Financial Statement Presentation* and PS3041 *Portfolio Investments* are effective for fiscal years commencing on or after April 1, 2022. – 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. – In July 2020, PSAB approved federal government narrow-scope amendments to PS3450 *Financial Instruments* which will be included in the Handbook in the fall of 2020. Based on stakeholder feedback, PSAB is considering other narrow-scope amendments related to the presentation and foreign currency requirements in PS3450 *Financial Instruments*. The exposure drafts were released in summer 2020.
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.

The following are active projects that the Public Sector Accounting Board are currently in the works. We have provided an overview of these projects and potential considerations on financial reporting.

Accounting projects	Summary and implications
PSAB's Draft 2022 – 2027 Strategic Plan	– PSAB's Draft 2022 – 2027 Strategic Plan was issued for public comment in May 2021. Comments were requested for October 6, 2021. – The Strategic Plan sets out broad strategic objectives that help guide PSAB in achieving its public interest mandate over a multi-year period and determining standard-setting priorities. – The Strategic Plan emphasizes four key priorities: • Develop relevant and high-quality accounting standards - Continue to develop relevant and high-quality accounting standards in line with PSAB's due process, including implementation of the international strategy (focused on adapting International Public Sector Accounting Standards for new standards) and completion of the Conceptual Framework and Reporting Model project. • Enhance and strengthen relationships with stakeholders - Includes increased engagement with Indigenous Governments and exploring the use of customized reporting. • Enhance and strengthen relationships with other standard setters – In addition to continued collaboration with other standard setters, this emphasizes strengthened relationship with the IPSASB. • Support forward-looking accounting and reporting initiatives – Supporting and encouraging ESG reporting, and consideration of the development of ESG reporting guidance for the Canadian public sector.
Government Not-for-Profit Strategy	– PSAB is in the process of reviewing its strategy for government not-for-profit ("GNFP") organizations. PSAB intends to understand GNFPs' fiscal and regulatory environment, and stakeholders' financial reporting needs. – PSAB released a second consultation paper in January 2021 which summarizes the feedback received to the first consultation paper. It also describes options for the GNFP strategy and the decision-making criteria used to evaluate the options. PSAB recommends incorporating the PS4200 series with potential customizations into PSAS. This means reviewing the existing PS4200 series to determine if they should be retained and added to PSAS. Incorporating the updated or amended PS4200 series standards in PSAS would make the guidance available to any public sector entity. Accounting and/or reporting customizations may be permitted if PSAB determines there are substantive and distinct accountabilities that warrant modification from PSAS. – PSAB is in the process of considering stakeholder comments.
Employee Future Benefit Obligation	– PSAB has initiated a review of sections PS3250 *Retirement Benefits* and PS3255 *Post-Employment Benefits, Compensated Absences and Termination Benefits*. In July 2020, PSAB approved a revised project plan. – PSAB intends to use principles from International Public Sector Accounting Standard 39 *Employee Benefits* as a starting point to develop the Canadian standard. – Given the complexity of issues involved and potential implications of any changes that may arise from the review of the existing guidance, PSAB will implement a multi-release strategy for the new standards. The first standard will provide foundational guidance. Subsequent standards will provide additional guidance on current and emerging issues. – PSAB released an exposure draft on proposed section PS3251, Employee Benefits in July 2021. Comments to PSAB on the proposed section are due by November 25, 2021. Proposed Section PS 3251 would apply to fiscal years beginning on or after April 1, 2026 and should be applied retroactively. Earlier adoption is permitted. The proposed PS3251 would replace existing Section PS 3250 and Section PS 3255. This proposed section would result in organizations recognizing the impact of revaluations of the net defined benefit liability (asset) immediately on the statement of financial position. Organizations would also assess the funding status of their post-employment benefit plans to determine the appropriate rate for discounting post-employment benefit obligations.

Accounting projects	Summary and implications
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. – PSAB released four exposure drafts in early 2021 for the proposed conceptual framework and proposed revised reporting model, and their related consequential amendments. The Board is in the process of considering stakeholder comments received. – PSAB is proposing 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. – In addition, PSAB is proposing: • Relocation of the net debt indicator to its own statement and the statement of net financial assets/liabilities, with the calculation of net debt refined to ensure its original meaning is retained. • Separating liabilities into financial liabilities and non-financial liabilities. • Restructuring the statement of financial position to present non-financial assets before liabilities. • Changes to common terminology used in the financial statements, including re-naming accumulated surplus (deficit) to net assets (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), including a new component called “accumulated other”. • 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.

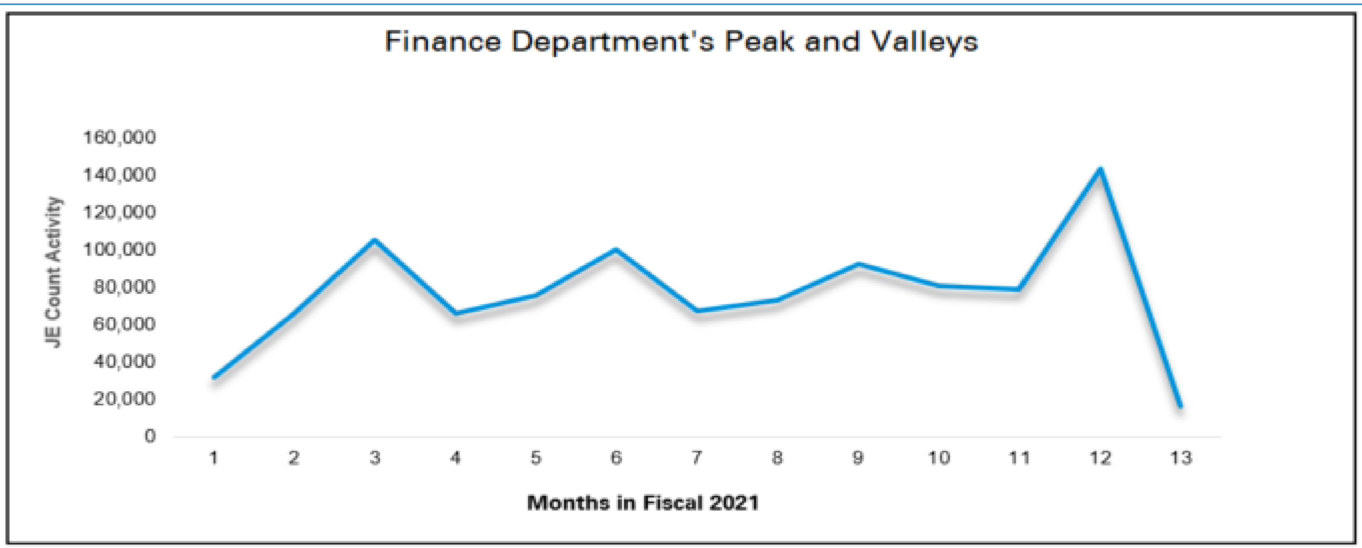
Appendix 3: Upcoming changes to auditing standards

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 4: Technology in the audit

As previously communicated in our Audit Planning Report, we have utilized technology to enhance the quality and effectiveness of the audit.

Technology	Areas of the audit where Advance Technology routines were used	Insights
KPMG Clara Data Management		
KPMG Clara Data Workbench is the universal data management platform that prepares and processes the data in support of the features and activities team performs within the workflow. This includes the import, data field mapping, account mapping, setting of parameters and processing of data for the KPMG Clara analytics, general ledger routines, data-enabled working papers and GL applications.	KPMG used the data management tool for journal entry and general ledger completeness testing. No issues were noted in the completeness testing. KPMG also performed journal entry analysis discussed on the next page.	KPMG analysed the general ledger for operational activity of the City of Toronto and noted peaks and valleys based purely on journal entry volume. The City has a significantly higher volume of financial activity at year-end. There is an opportunity for the City to leverage its month-end periods to reduce the number of manual adjustments recognized at year-end.



Journal Entry Analysis (JEA)

JEA utilized the journal entry transactional data to allow the audit team to enable drill down capabilities. These drill down capabilities allow our teams to understand the trends, patterns, relationships and screening of journal entries using pre-defined and entity specific criteria.

KPMG performed journal entry screening as part of the planning and risk assessment procedures.

KPMG used this tool for identifying and extracting the journal entries for testing purposes using entity specific high-risk criteria.

Based on this testing, no issues were noted.

KPMG analysed the general ledger of the City of Toronto and noted the following insights:

- The number of manual entries is quite significant especially in period 12 and post close. In 2021, 27,276 (2020 - 32,963) manual entries were posted in December and 2022 post closing period. There is an opportunity for the City to capitalize on system solution to alleviate some of these manual entries at year-end.
- Analysis of the split between Manual and Automated noted that on average, the Entity's Journal entries split is 14% (2020 - 15%) Manual and 86% (2020 – 85%) Automated.
- There were no Journal entries missing description.

There were no journal entries missing user ID.

Account Analysis

Account analysis is a risk assessment tool that performs an automated analysis of an entity's journal entries, comparing them with predetermined assumptions and determining whether those entries reflect 'expected', 'unexpected' or other types of account combinations (also referred to as account pairing). Account analysis results assist us in obtaining an understanding of the entity's accounting processes and recording of transactions, while identifying and assessing potential risks of material misstatements and enabling the determination of an audit approach specifically responsive to such risks.

KPMG performed Account Analysis on some of the significant accounts for the entity. These accounts included tangible capital assets, long-term debt, and cash and cash equivalents.

This analysis was used as part of the risk assessment process for the audit of the Entity's financial statements. This tool helped KPMG in highlighting areas to focus on as part of substantive testing by identifying expected and unexpected entries for these significant accounts.

Nothing to note.

KPMG Clara Client Collaboration site		
KCCC is our secure audit platform and a one-stop shop through which we manage the audit requests for planning, interim and year-end audit. This tool also provides Management with real-time access to the status of information requests by category i.e. received to date, pending past due date, and pending not due. This provides exchange of information and real time project management reporting to Management in one central location.	This tool is used to request and receive all audit requests from clients, including the City. This tool is web-based and allows the finance team to upload responses to our specific requests via secure link on the web portal.	Nothing to note.
IRM Involvement		
We leverage General IT Controls and IT Application Controls in our audit approach related to payroll. Our IRM team employs their knowledge and understanding of the IT systems and controls in place and performs their testing based on this understanding.	Involvement of IRM in our audit team provided us with audit evidence related controls in place for payroll and allowed us to build and design a better overall audit approach.	Nothing to note.

Appendix 5: 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
Hybrid Workplace Guide	In this eBook, you'll discover: The business case for building a hybrid workplace: What are the benefits of a hybrid work model? From employee attraction and retention to achieving enterprise-wide cost efficiencies. The flexibility imperative: How do you create a successful hybrid workplace model that balances employees and organizations' needs and wants? From remote work to safely supporting more face to face interactions. The building blocks of a hybrid workplace: We address human, organizational, regulatory, digital and physical considerations, and aspects such as how do you manage digital and cybersecurity when working from home in a hybrid workplace model? How can management lead by motivation and results for better employee engagement? Returning to the physical workplace: How do you ensure a safe workplace when employees return to the office space in a hybrid workplace model? How can you emphasize safety to instill confidence in your employees?	Learn more

	Legal considerations of a hybrid work model: What could the tax implications be for companies if they implement a hybrid workplace model? Considerations to help you navigate the risks of hybrid work, including changing policies, approaches for new vs. existing employees, and security and privacy.	
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**
KPMG Learning Academy	Technical accounting and finance courses designed to arm you with leading-edge skills needed in today's disruptive environment.	**Learn more**

Appendix 6: Draft auditors' report

Appendix 7: Management representation letter

Appendix 8: Why Audit Committees should know about Asset Retirement Obligations

(see attachment below)

Appendix: Why Audit Committees should know about Asset Retirement Obligations

home.kpmg/ca

Table of content

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.

KPMG

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.

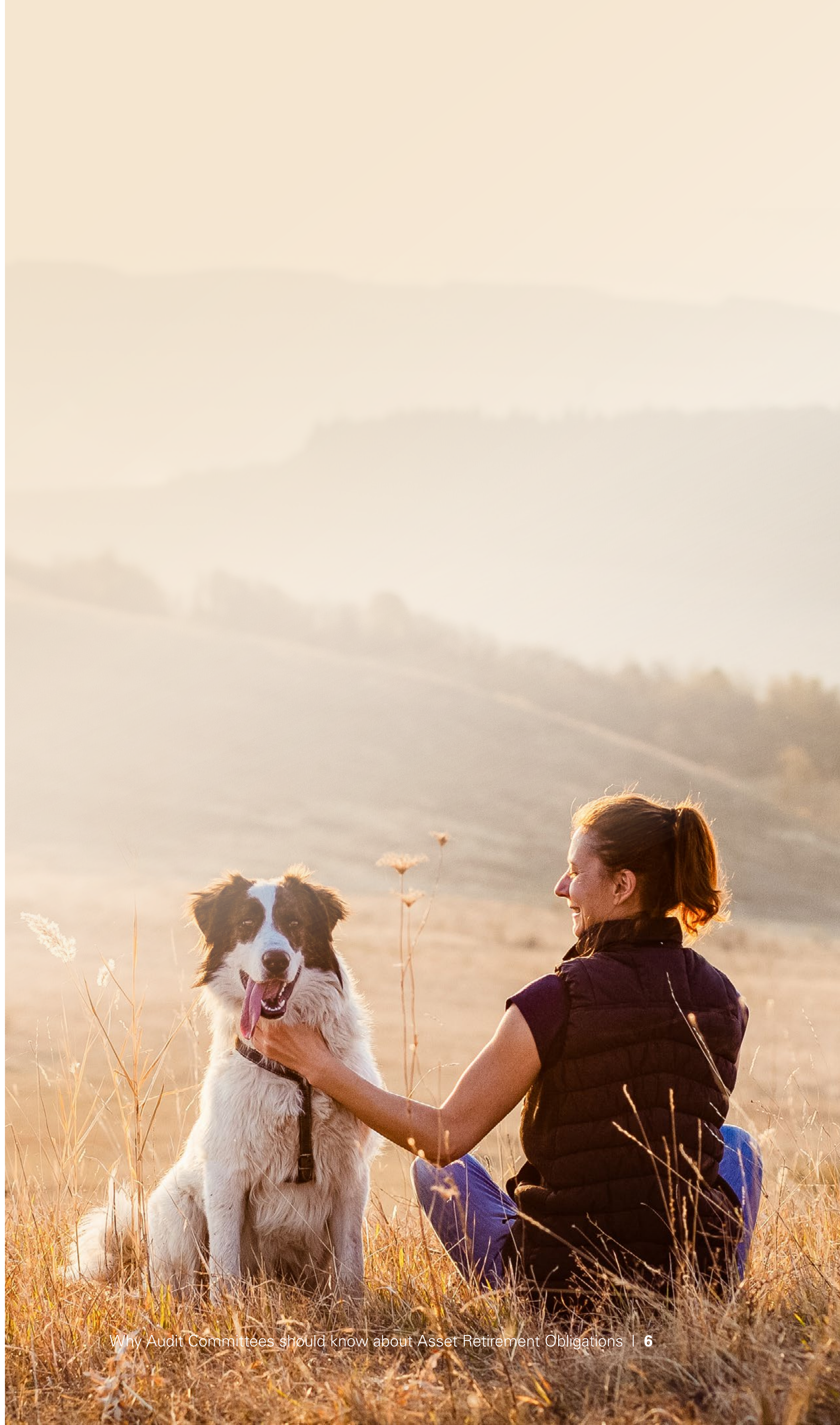
c. Completeness of assets

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

home.kpmg/ca

Be social with **@KPMGCanada**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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

(see attachment below)

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

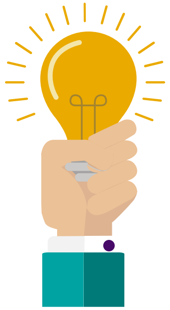
- ESG-related information is frequently disclosed outside of traditional financial statements whether in be in separate sustainability reports but also could be within the MD&A and/or AIF
- Such information can be in the form of key metrics as identified by management or specific qualitative information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

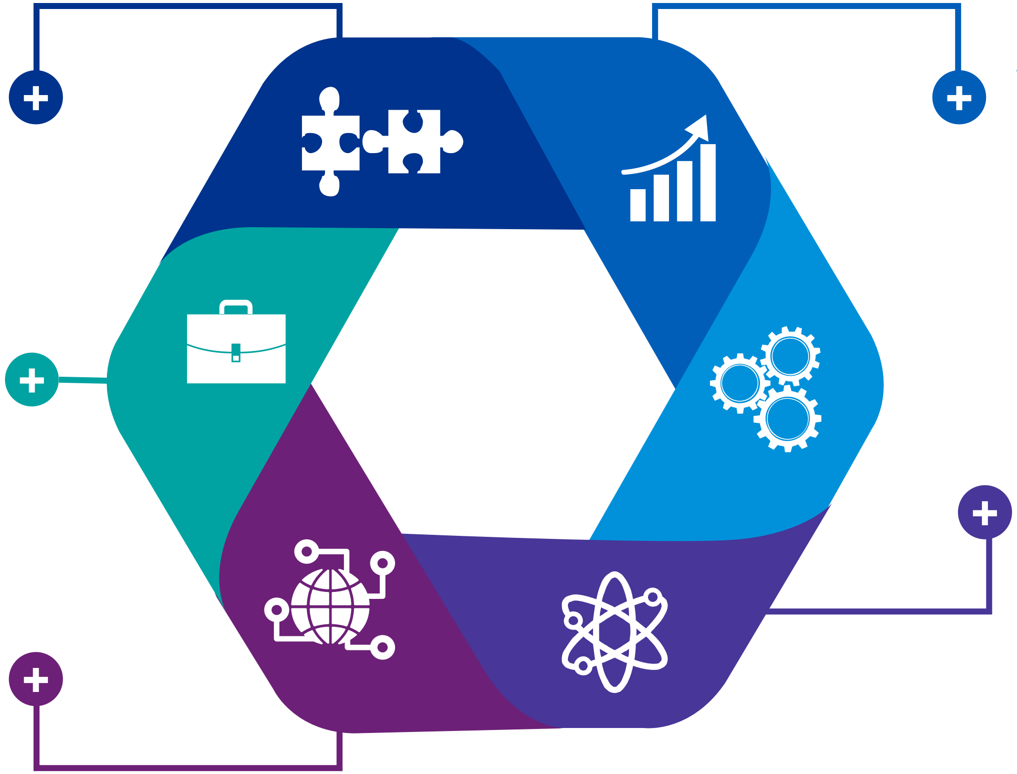
The Audit Committee will need to be involved in overseeing the development of policies, systems, processes, internal controls, governance and assurance for ESG data and reporting similar to that which is in place for collecting and disclosing financial information.

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

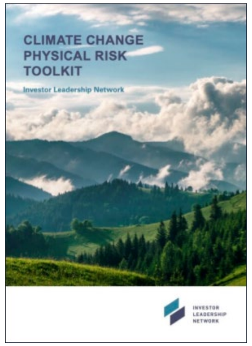
At KPMG we invest heavily in deepening our knowledge of ESG key trends, technical issues and differences among sectors. This ensures we remain at the forefront of our field.

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)

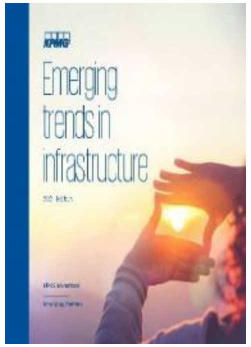
Climate Change Physical Risk Toolkit (2021)



Supporting Growth and Ensuring Care (2020)

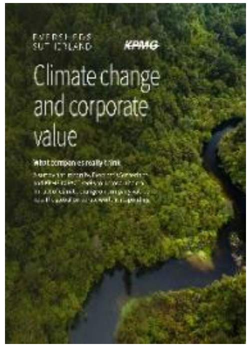
Business and the environment (2020)

Emerging Trends in Infrastructure 2021 Edition (2021)

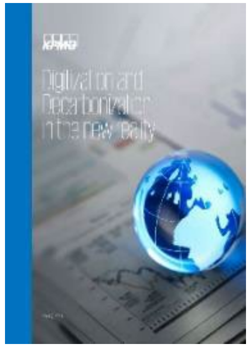


You can't go green without blue (2021)

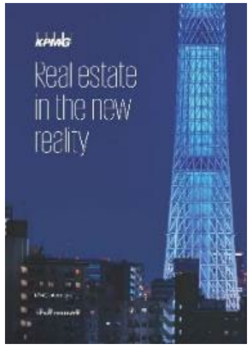
Climate change and corporate value (2020)



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)

kpmg.ca/audit