

# **The City of Ottawa**

## 2019 audit results

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Members of the Audit Committee (the “Committee”)

The City of Ottawa

Dear Members of the Committee:

We are pleased to present the results of our audit of the consolidated financial statements of the City of Ottawa (the “City”). This report also includes the status of our audit, which we anticipate will be completed by June 10, 2020.

Our audit was designed to express an opinion on the 2019 consolidated financial statements. We continue to receive the full support and assistance of the City’s personnel in conducting our audit. Open and candid dialogue with you, is a critical step in the audit process, and in the overall corporate governance process and we appreciate this opportunity to share the insights from our audit with you.

This report is intended solely for the information and use of the members of the Audit Committee and management. It is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style script.

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## Executive Summary

### Status

- The 2019 audit is progressing as planned. After completing our remaining procedures, as outlined in “Open items” below, we expect to issue an unmodified opinion on the consolidated financial statements.

### Scope

- Our audit scope is consistent with the plan communicated in November 2019. We continually reassess our planned audit approach to address areas of risk and audit emphasis throughout the audit.

### Results

- The City’s analysis of significant accounting matters is reasonable;
- Consistent methodology and reasonable judgments have been used by management to account for sensitive accounting estimates;
- Corrected and uncorrected misstatements were identified as a result of the audit; any significant differences identified as part of our audit procedures are described in this report;
- We were able to rely on certain information technology (IT) general controls as well as certain controls over accounts payable, expenditures and payroll for purposes of our audit;
- COVID-19 has and will continue to disrupt the City’s business activities and our typical audit process. Using collaborative technology and our audit platform, it enabled us to stay connected with City staff, virtually conduct all regular touch points and meetings and overall enabled us to conduct and complete a quality audit execution; and
- Ongoing cooperation and communication between the City and EY supported an effective audit process.

### Open items

- Obtain final documentation from the component audit team of Hydro Ottawa Holding Inc.;
- Complete and perform final review of working papers
- Obtain a letter of representation from management as of the date that the consolidated financial statements are approved by Council (anticipated approval to be June 10, 2020);
- Perform final procedures relating to our review of the City’s annual report;
- Complete subsequent events review procedures to the date of our audit report;
- Obtain legal letters from internal and external counsel; and
- Assess any fraud or subsequent events information provided during our meeting.

## **Accounting policies, estimates and areas of audit emphasis**

Our audit plan was communicated at the audit planning meeting held in November 2019. There were no significant changes in the planned scope and timing of our audit other than those noted in this report.

Our audit procedures emphasized testing those processes, accounts, contracts or transactions where we believed there was the greatest potential for risk of material misstatement to the consolidated financial statements, whether due to error or fraud, including disclosure items. We have applied the concept of materiality in planning and in performing the audit. In evaluating the effect of identified misstatements on the audit we have considered both a quantitative materiality threshold as well as qualitative factors such as the nature of the error, the impact on the economic decision of users, and the impact on key ratios.

Provided below is a summary of the City's critical accounting policies and sensitive accounting estimates, which are in accordance with Public Sector Accounting Standards (PSAS).

### **Revenue Recognition**

The City has various revenue streams including taxation revenue, government transfers, development charges and, fees and user charges.

For each stream of revenue, we walked through and validated our understanding of the flow of transactions and performed test of details over a sample of transactions as well as confirmations and analytic procedures. As a result of our audit procedures over the Light Rail Transit (LRT) Stage 2 project, we noted an understatement of government transfer revenue and accounts receivable of \$69M related to expenditures incurred on LRT Stage 2 during fiscal 2019. The City has corrected this difference in the financial statements.

As part of government transfer revenue testing, we noted that the provincial gas tax revenue was not recorded in the appropriate period. The standards require that the City record the amount when the City is eligible, and the province authorizes the funding. The City recorded the amount authorized in 2019 in its 2018 financial statements and the amount authorized in 2020 in its 2019 financial statements. This error resulted in an overstatement of the gas tax receivable of \$36.5M at December 31, 2019 and a net understatement of the annual surplus for 2019 of \$615K. Management has not corrected this difference.

Based on the procedures performed to-date, other than the differences identified above, the City's accounting for taxation revenue, government transfers, development charges, and fees and user charges revenue appears reasonable.

## **Contingent Liabilities and Other Payables**

We confirmed with both in-house and external legal counsel (if applicable) to assess the completeness of the contingent liabilities reported by management. In addition, we performed detail testing to support accounts payable and accruals.

As a result of the audit procedures performed, we noted an understatement of contingent liabilities of approximately \$15.3M. This understatement is the result of changes in estimates identified after year-end but related to claims which existed at year-end. A similar difference exists related to the prior year resulting in a net overstatement of the annual surplus in 2019 of \$7.1M. Management has not corrected this difference.

In addition, our procedures over accounts payable and accrued liabilities included the review of the Hydro Ottawa Holdings Inc. (HOHI) payables to support that intercompany amounts were appropriately recorded in the City's consolidated financial statements. In performing these procedures, we identified a receivable in the HOHI financial statements which was not recorded as a payable in the City's financial statements. As a result, the accounts payable and accrued liabilities are understated by \$13.4M causing a net overstatement of the annual surplus of \$2.3M after the impact of the related turnaround error identified in the prior year. Management has not corrected this difference.

Based on the procedures performed to-date, other than the differences noted above, the City's accounting for contingent liabilities and other payables appears reasonable.

## **Investments and Financial Instruments**

We confirmed the City's investment maturity dates, par values, market values, and coupon rates with the custodian of the investments. In addition, we tested the market value of a sample of investments and recalculated the carrying value and the accrued interest, and completed a reasonability over the investment income earned during the year. In performing these procedures, we also assessed whether there have been any other-than-temporary impairments where the carrying value of the City's investments was significantly higher than market value.

Based on the procedures performed to-date, the City's accounting for investments and financial instruments balances recorded at December 31, 2019 appears reasonable.

## **Employee Benefit Costs**

We engaged our internal actuarial specialists to review the key assumptions used in accounting for the actuarial valuation prepared at December 31, 2019 for each of the Ottawa-Carleton Regional Transit Commission Employees' Pension Plan, the City of Ottawa Superannuation Fund ("COSF"), the other non-pension post-retirement and post-employment benefits ("OPEB"), and the Self-Insured Workers' Compensation

Benefit (“WSIB”). We also reviewed the approach applied by management’s external experts (the “actuaries”) in performing the valuation. We reviewed the valuation methods and assumptions used by the actuaries and verified that the methods and assumptions were in accordance with PSAS. In addition, we assessed the reasonableness of the disclosures.

As a result of our procedures, we noted a carryforward error related to employee future benefits. This difference was the result of a clarification of certain pre-existing plan provisions, which resulted in increasing the obligation. As the difference is being amortized through the Statement of Operations over the estimated average service life of employees rather than being recognized in the year it was identified, the difference will reverse gradually over future years. The current year impact is an understatement of the annual surplus of \$0.5M and an understatement of the liabilities of \$6.0M.

Based on the procedures performed to-date, other than the differences as described above, no issues were noted.

## **Tangible Capital Assets**

We audited the City’s December 31, 2019 tangible capital assets balance and the related fiscal 2019 activity, consisting of additions, disposals, and amortization. Our audit approach was supported by data analytics and detailed testing over additions/disposals during the year and the related timing of capitalization. Additionally, recalculation of the amortization expense was performed.

We reviewed the agreements related to the Ottawa LRT project, including accounting analysis of all the costs associated with the project and concluded that the City’s treatment of tangible capital assets and commitments related to Stage 1 and Stage 2 of the project appears reasonable.

As a result of the procedures over tangible capital assets, one error was identified in 2012 which continues to impact the statements in 2019. More specifically, the City continues to amortize certain tangible capital assets through the statement of operations which should have been amortized in 2012. This error results in an overstatement of tangible capital assets of \$12.3M, and a net understatement of the annual surplus of \$1.1M.

Based on the procedures performed to-date, other than the differences identified above, no issues were noted.

## **Commitments**

We assessed whether commitments were disclosed based on agreements and contracts entered into by the City during the year. We tested the valuation of commitments included in the consolidated financial statements on a sample basis,

including commitments for phase 2 of the LRT project. In addition, we inspected the agreements and supporting documentation as it pertains to the approval of the construction of Phase 2 of the LRT project to verify that the amounts are appropriately recognized on the financial statements and disclosed as part of the commitment note.

Based on the procedures performed to-date, the City's accounting for commitments appears reasonable.

## **Net Long-Term Debt**

We confirmed the City's debt including the amount of original issuance, debt outstanding, maturity dates, and interest rates. We verified the completeness of future long-term debt principal repayments disclosed in the notes of the financial statements and tested a sample. In addition, we assessed the City's compliance with limits prescribed by the capital budget and Ministry of Municipal Affairs and Housing.

Based on the procedures performed to-date, we noted that in 2017, the City executed an Assumption and Assignment Agreement with the long-term lenders for Stage 1 of the LRT project and, in exchange, issued debentures with the equivalent principal amount and repayment schedule. The long-term receivable from Project Company was netted against the net long-term debt, resulting in a \$225M understatement of long-term receivables and net long-term debt on the current and prior year Statement of Financial Position. The related interest income and interest expense of \$11.0M (2018 – \$11.0M) has also been presented net rather than gross on the Statement of Operations. This difference does not impact the annual surplus of the City and has a minimal impact on the City's debt service ratio (0.35%). The debt servicing is expected to be covered by the long-term receivable as all payments and interest are mirrored in the two agreements. Although the amount is above materiality in quantitative terms, disclosure of the transaction has been included in Note 11 of the financial statements, and the misclassification has limited impact on key ratios and indicators within the financial statements. Management has not corrected the difference as they believe the current accounting reflects the substance of the transaction. Based on the above factors and the disclosures describing the transaction and related accounting in the financial statements, we do not believe that the misclassification is material to users of the financial statements.

Based on the procedures performed to-date, other than the difference identified above, no issues were noted.

## **Adoption of New Accounting Standards**

The City adopted PS 3430 - *Restructuring Transactions* in fiscal 2019. Management has disclosed the adoption and impact of the new standard in Note 2 to the financial statements and has concluded that the adoption of this standard did not result in any financial impact or significant changes to the financial statements.



Based on the procedures performed to-date, the City's adoption of the new accounting standards appears reasonable.

## **Subsequent Event Disclosure**

Subsequent to year-end, the outbreak of the Coronavirus disease (COVID-19) has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. A subsequent event note has been included in the consolidated financial statements. There is no financial impact on the 2019 consolidated financial statements. We will assess the impact to 2020 in the next fiscal year.

## **Inquiries relating to matters relevant to the audit**

In line with our audit plan, we are responsible for performing inquiries of those charged with governance related to fraud and other matters that help inform our audit strategy and the execution of our audit procedures.

We ask that the Committee please provide us with information on any other matters of which you believe we should be aware, including, but not limited to the following:

- Your views about the risks of material misstatements due to fraud;
- Your knowledge of any actual, alleged or suspected fraud which could have a significant impact on the financial statements;
- Your awareness of tips or complaints regarding the City's financial reporting which could have a significant impact on the financial statements; and,
- Your awareness of any other matters relevant to the audit including, but not limited to, violations or possible violations of laws or regulations.

Under Canadian Auditing Standards, we are required to communicate certain findings from the audit to the Audit Committee that may assist its members in overseeing management's financial reporting and disclosure process. We have included all required information in this report.

## **Fraud considerations and the risk of management override**

We are responsible for planning and performing our audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether caused by error or by fraud (CAS 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*).

Our audit procedures encompassed the requirements of CAS 240: brainstorming, gathering information to facilitate the identification of and response to fraud risks and performing certain procedures to address the risk of management override, including examining journal entries, reviewing accounting estimates and evaluating the business rationale of significant unusual transactions.

Other than the presumed risk of management override, no fraud risks were identified which could be material to the consolidated financial statements.

## Summary of significant audit differences

During the course of our audit, we accumulate differences between amounts recorded by the City and amounts that we believe are required to be recorded or reported under PSAS. The following is a summary of significant audit differences we have identified through the date of this report that have not been adjusted by the City. When assessing the significant audit differences and their impact on the fair presentation of the consolidated financial statements, in all material respects, we consider both quantitative and qualitative criteria in performing our assessment such as the nature of the misstatements, the impact on the economic decision of users, and the impact on key ratios. Although the unadjusted differences included on our detailed summary of audit differences are not considered to be material to the 2019 consolidated financial statements, they could cause a future period's consolidated financial statements to be materially misstated. As a result, we encourage the recording of all audit differences whether significant or not.

All differences have been described above in the areas of audit emphasis. The net impact of the differences as they relate to primary measures of the financial position and operations of the government are presented below:

<i>Net impact of misstatements on financial statements</i>	<i>Overstatement (understatement)</i>
Net debt	(\$71.2M)
Non-financial assets	\$12.4M
Annual surplus	\$7.2M

## Summary of significant disclosure differences

During the course of our audit, we identify those significant disclosures required in the 2019 consolidated financial statements of the City, that we believe were not adequately reflected. There were no significant unadjusted disclosure differences identified.

## Other required communications

We will read the City's Annual Report and Financial Discussion and Analysis when it becomes available and if, based on the work we will perform on this other information, we identify any material misstatements in this other information, we will report this fact to you.

As in prior years, the letter of representation, final summary of unrecorded audit differences, and our independence letter will be circulated a few days prior to final approval of the statements.

There are no other findings or issues arising from the audit that are, in our judgment, significant and relevant to the Audit Committee regarding the oversight of the financial reporting process.

Other than described in the financial statements, we are unaware of any other subsequent events that have occurred that could affect the consolidated financial statements.

No matters were noted for discussion with the Committee in relation to our audits of significant component entities of the City including Hydro Ottawa Holding Inc. and Ottawa Community Housing Corporation, other than those noted above.

We are not aware of any matters that in our professional judgment would impair our independence.

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