Attachment 3

The Corporation of the City of Vaughan

Audit Findings Report
for the year ended December 31, 2021

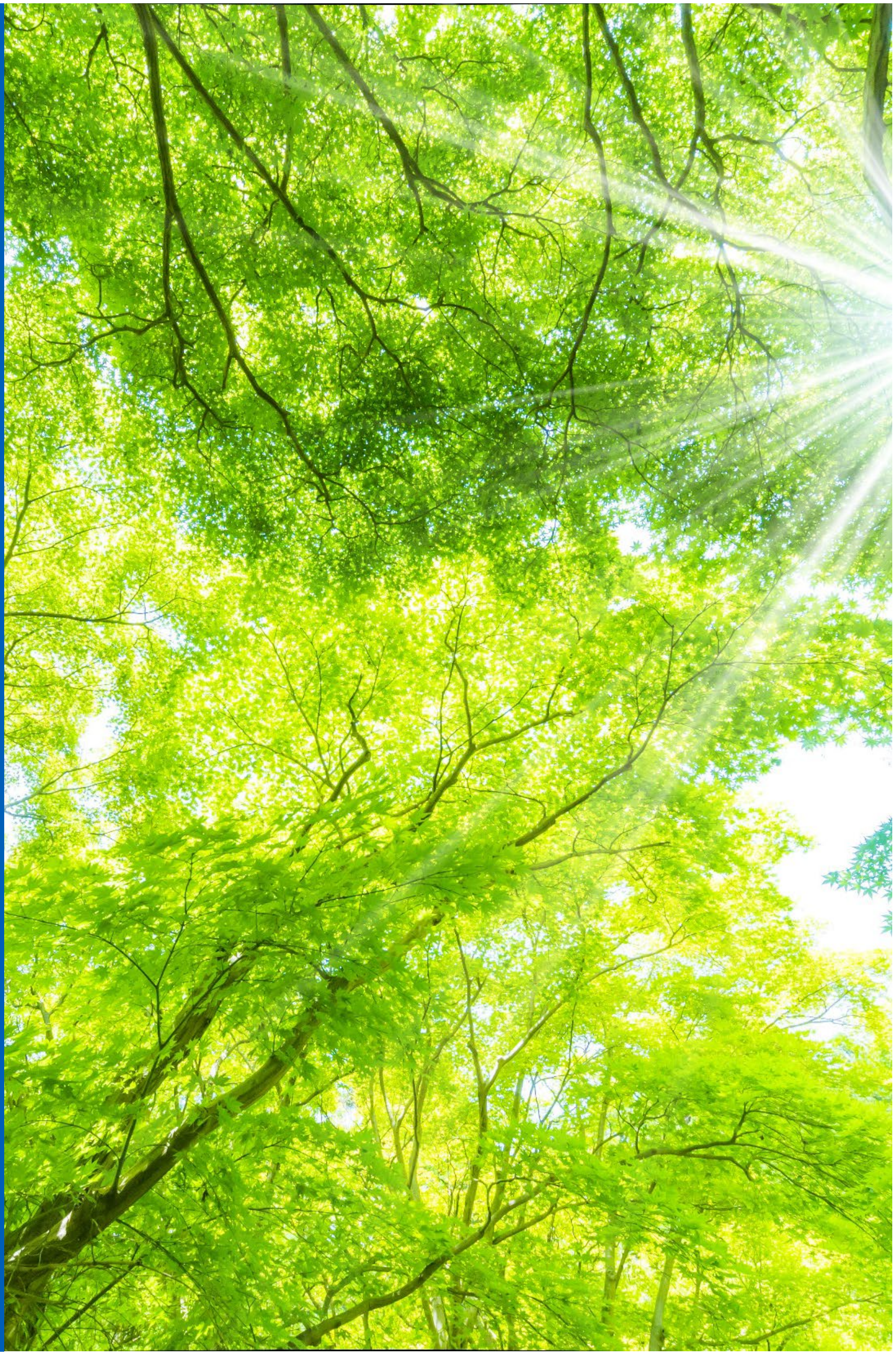
KPMG LLP

Licensed Public Accountants

Prepared on May 10, 2022 for

Presentation on June 13, 2022

kpmg.ca/audit



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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.

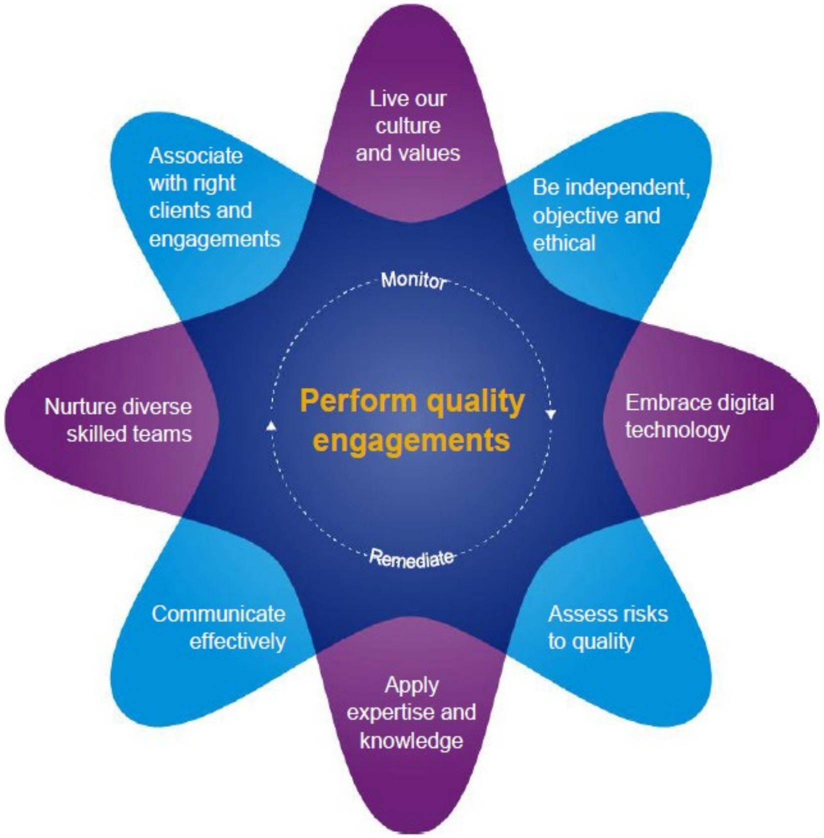
Audit Quality: How do we deliver audit quality?

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 (the "financial statements") of the Corporation of the City of Vaughan (the "City") as at and for the year ended December 31, 2021. This report builds on the Audit Plan we presented to you on November 22, 2021.

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:

- Completion of audit quality control procedures
- Completing subsequent events procedures, up to the date of approval of the financial statements, including receipt of the final legal enquiry letter
- Receipt of the signed management representation letter (dated upon City Council approval of the financial statements)
- Completing our discussions with the Audit Committee
- Obtaining evidence of City Council's approval of the financial statements.

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 have been no significant changes regarding our audit from the Audit Planning Report previously presented 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.

Uncorrected audit misstatements

We did not identify differences that remain uncorrected.
Refer to page 14.

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.

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[1] This report to the Audit Committee is intended solely for the information and use of Management, the Audit Committee, and City Council 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.

Significant accounting policies and practices

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

Independence

We are independent with respect to the City, within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies in Canada and any other standards or applicable legislation or regulation.

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.

Fraud risk from revenue recognition	New or changed?	Estimate?
This is a presumed fraud risk. The identified fraud risk is over revenue recognition related to revenue transactions that are not in the normal course of business and deferred revenue. The primary risk of fraudulent revenue recognition resides with manual journal entries for revenue transactions not in the normal course of business as well as management's calculation of the deferred revenue – obligatory reserve funds.	Same as prior year.	No significant estimates noted.

Our response

In order to address the presumed fraud risk from revenue recognition, we performed various audit procedures over the City's process for recognizing revenue, including:

– evaluated the design and implementation of selected relevant controls over manual journal entries and other adjustments for revenue transactions.

– evaluated the design and implementation of selected relevant controls, including those relating to the tracking and reporting of obligatory reserves revenue recognition.

Significant findings

– We tested journal entries that are susceptible to manipulation through management override and unusual journal entries. See further details on page 18.

– 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) and analyzed spent and earned obligatory reserve funds for which corresponding revenues are recognized.

– We obtained and reviewed the continuity for deferred revenue prepared by management. We selected a sample of the increases (cash receipts) and decreases (revenue recognition) for deferred revenue during the current year.

– In testing recognition of revenue, we assessed if development charges received in prior years were used to fund capital expenditures in the current year and in accordance with the appropriate legislation. Based on our procedures, we conclude that the development charges and other restricted grants recorded as revenue in fiscal 2021 were used to fund eligible capital projects

– We did not identify any issues related to fraud risk associated with revenue recognition.

Audit risks and results

Fraud risk from management override of controls	New or changed?	Estimate?
Management override of controls is a presumed significant risk as prescribed by professional auditing standards.	Same as prior year.	No significant estimates noted.

Our response

- The risk resides with management's ability 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.
- We have utilized Data & Analytics ("D&A") in order to enhance the quality and effectiveness of the audit, specifically with respect to testing 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 adequate.
- We evaluated the business rationale of significant unusual transactions.
- Additionally, we incorporated an element of unpredictability whereby we perform an unpredictable procedure, or make changes to a standard 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 18 for further details in this area.
- We did not identify any issues or concerns after performing our review of estimates. See page 8 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 also verified whether vendor background checks were performed for any vendors that were newly set up during the year from our sample selection. There were no issues or exceptions found in carrying out this test.

Other areas of focus

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.

Employee Future Benefits	New or changed?	Estimate?
There is estimation uncertainty due to assumptions and estimates used by the actuary in calculating the liability for the City's post-retirement non-pension benefits and WSIB. 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. Generally, these are considered to be "estimates with significant risk."	Same as prior year; a valuation was completed in 2020.	Yes, there is estimation uncertainty due to assumptions used by the actuary to calculate the liability for the Employee Future Benefits.

Our response

– We obtained the actuarial valuation report and audited the data, method and assumptions applied in the valuation and performed trend analysis on the liability.
– 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 public sector accounting standards.

Significant findings

– Based on our review of the report prepared by the actuary, we noted that the method applied for the estimate is acceptable per the Canadian Institute of Actuaries and Public Sector Accounting Standards (PSAS) 3250 *Retirement Benefits.*
– We assessed the key assumptions used by the actuary in light of the City's financial results. We also performed a sideways glance to compare the assumptions used by the actuary for the City with other Ontario municipalities and we did not note any significant differences.
– We noted that the discount rate used by the actuary is a key assumption. Discount rates of 3.0% (2020 – 3.0%) were used for the determination of the liability. We evaluated the discount rates against the discount rate curve issued by different reliable sources including CIA, FIERA and KPMG LLP. Based on this evaluation, we concluded that the discount rates used are reasonable.
– The disclosures included in the financial statements are in accordance with the requirements of the public sector accounting standards.
– Based on the audit work performed, we did not note any issues related to the calculation of the City's non-pension retirement benefits and WSIB liability as at December 31, 2021.
– The employee future benefit liabilities as at December 31, 2021 are outlined in note 5 to the financial statements.

Other areas of focus

Revenue, Safe Restart Grants, and Deferred Revenues	New or changed?	Estimate?
The City recognizes revenue from different streams including taxation, user charges, government transfers, contributions from developers, investment income, contributed assets, and other. Management follows the revenue recognition policies reported in note 1 to the financial statements to recognize revenue in accordance with PSAS, which includes deferring receipts and contributions if performance obligations are not met.	Same as prior year.	No significant estimates noted.

Our response

- We substantively tested revenues recognized and amounts held as deferred at year end using sampling techniques and direct confirmation of certain revenues with third parties, including other governments and agencies.
- We obtained the Safe Restart Phase 2 and COVID-19 Recovery Funding for Municipalities program funding letters, amongst other grants, and agreed amounts recorded to the funding agreements, and vouched to cash receipts.
- We reviewed the calculation of deferred revenue continuity prepared by management and ensured the cash receipts and revenue recognized ties to our audited work.
- We tested a sample of cash receipts to supporting agreements and bank records and found no issues in the deferral of these receipts.
- We tested a sample of expended funds to supporting records of the underlying expenditures, noting that the expenditures were related to the purpose for which the contributions were recorded, and found no issues in the recognition of funds as revenue.

Significant findings

- The City received total funding of $10.9M (2020 - $6.1M) under the Safe Restart programs from the provincial government to support operations in light of COVID-19, all of which was appropriately recognized during the year.
- Based on the audit work performed, the amounts reported for revenue and deferred revenue - obligatory reserve funds as at year end are reasonable.
- The note disclosures related to revenue and deferred revenue - obligatory reserves funds are in accordance with PSAS.

Other areas of focus

YMCA Project	New or changed?	Estimate?
In 2017, the City entered into an arrangement with YMCA of Greater Toronto Area ("YMCA") and Penguin Calloway Vaughan Partnership for the construction of a YMCA and City Facility (together, "facility") that is within a mixed use building being developed in the Vaughan Metropolitan Centre. The City is funding a significant portion of the construction costs and is guarantor to the YMCA's share of financing.	Same as prior year.	No significant estimates noted.

Our response

- We obtained and reviewed relevant agreements related to this facility between the City and other parties.
- We reviewed the detail of costs related to this facility that were incurred during 2021.
- We obtained direct confirmation from YMCA of the long-term debt and repayment schedule owing to them, including confirmation that YMCA has not defaulted on their loan with Ontario Infrastructure and Lands Corporation (OILC) as at December 31, 2021, and confirmed with management subsequently up to the date of this report.

Significant findings

- The facility will be shared between the City and YMCA for occupancy whereby the City will use 30% of the facility and YMCA will use the remaining 70%.
- The City is funding its 30% share of the facility and 2/3 of YMCA's 70% share of the facility.
- YMCA entered into a financing agreement with OILC to obtain a construction loan of up to $66M, which the City has guaranteed. In the event of default by YMCA, the City is required to assume all liabilities and take first right to ownership of all assets related to the facility.
- As at December 31, 2021, the City has incurred a cumulative $69.9M (2020 - $64.1M) on the project, comprising:

(millions)	2021	2020
Land	$11.0	$11.0
Land transfer tax	1.5	1.5
The City's portion of the facility	22.0	19.8
The YMCA's portion of the facility	35.4	31.8
	$69.9	$64.1

- The City has reported the $69.9M (2020 - $64.1M) as assets under construction as part of its tangible capital assets. A total of $22.6M (2020 - $16.8M) has been paid by the City with a remainder of $47.3M (2020 - $47.3M) recorded as long-term debt.
- These transactions are described in note 7 to the financial statements, including the repayment schedule of debt payments owing to YMCA.
- We did not note any issues with management's accounting, and we find the measurement and disclosures related to this project to be appropriate.

Other areas of focus

Vaughan Holdings Inc.	New or changed?	Estimate?
Vaughan Holdings Inc. ("VHI"), a significant component of the City's consolidated financial statements, is accounted for on a modified equity basis. VHI, together with its holdings in Alectra Inc. ("Alectra") and other entities, is referred to as Hydro Vaughan Corporations.	Same as prior year.	No significant estimates noted.

Our response

- We verified the transactions between each of the City, VHI, and Alectra and performed a reconciliation of the amounts reported in the financial statements of the respective entities as at December 31, 2021.
- We vouched dividends received from Alectra to VHI, and as well from VHI to the City, to supporting documentation and cash receipts.

Significant findings

- The City recognizes its investment in Hydro Vaughan Corporations using the modified equity method. Using the criteria under Public Sector Accounting Standards, *3070 – Investment in Government Business Enterprises*, we determined that the City's investment in Hydro Vaughan Corporations continues to meet the criteria of the standard, and therefore it is appropriate to continue to record the investment using the modified equity method of accounting.
- In 2021, the City's share of Hydro Vaughan Corporations' net income and dividends paid out totalled $23.5M and $13.7M, respectively (2020 - $16.1M and $13.1M, respectively).
- VHI received a $1.1M (2020 - $1.7M) return of capital from Alectra, which was recorded as a reduction to VHI's investment in Alectra. VHI issued an equivalent return of capital of $1.1M to the City.
- These transactions are described in note 4 to the financial statements.
- Based on our audit, we conclude that management has appropriately recorded and presented its investment in Hydro Vaughan Corporations using the modified equity accounting.

Other areas of focus

Contingent liabilities	New or changed?	Estimate?
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.	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 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 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 reviewed Council and committee meeting minutes to determine the completeness of contingencies and held discussions thereon with senior management, including internal legal representatives.

Significant findings

- We reviewed the listing of active litigation and potential claims provided by internal legal counsel and reviewed assessments of each matter and the process employed to develop and record the related estimated liabilities. Management has determined that an accrual is not warranted based on the likely amounts of loss after accounting for insurance coverage.
- As these items are resolved, 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.
- Based on the work performed, the assessment for contingent liabilities made by the City is reasonable.

Other matters

Professional standards require us to communicate to the Committee other matters. We highlight the following that we would like to bring to your attention:

Matter	Comments
Vacation accrual	Disclosed in the financial statements is vacation entitlements liability (see note 5(c)), which is $11.5M in 2021 (2020 - $9.4M). The City's various collective agreements, Management bylaw and other HR policies permit certain maximum days to be carried over if unused. As reported in our audit results of 2020 and 2019, we continue to note that there is an upward trend in this accrual over the past several years and we understand that this increase is due to factors such as compensation increases and increased number of unused days carried over. Consistent with the prior years, we note that there are several risks associated with maintaining high levels of vacation accruals, for example, the cost of those vacation entitlements become increasingly more expensive as compensation levels increase, it can be potentially disruptive to the City's operations in the case where employees are granted extended leaves, and the financial impact to the City's financial position becomes less favourable as more reliance is placed on reserves or future funding in order to fund this liability. In line with leading practices, we recommend that management carefully assess vacation entitlements, enforce any plans in place to draw down on entitlements in order to better manage this liability and avoid servicing it at a higher cost than necessary. We note that in 2022, this liability may continue to rise if employees continue to defer vacation plans. We understand that senior management will further enhance enforcement efforts of carry-forward policies with a specific objective of drawing down the liability. Additionally, as another leading practice and as a fraud prevention measure, we note that management should ensure that staff take annual vacations and that another employee perform their work in their absence. This cost-efficient control is one of the most effective methods of identifying any potential irregularities in performance. It also provides cross training for succession planning purposes. Management's response: In September of 2021, all staff were provided notice that moving forward, the Management By-law and Collective Agreements will be adhered to regarding vacation usage. In order to provide employees with adequate time and options to reduce the ongoing liability associated with high vacation banks, the following were implemented: Staff with vacation in excess of the Management By-law/Collective Agreements have the ability to request a vacation payout, of up to 30 days, in both 2022 and 2023. – To support the transition, staff were able to carry over an additional 5 or 10 days (union vs. non-union) for 2022 only. – Effective January 1, 2023, all vacation entitlements, as per employment agreements will be strictly enforced regarding carry over and vacation reserve balances. – Any exceptional circumstances may be granted an exemption by the Deputy City Manager/City Manager. Operational requirements will not be considered to be an exemption.

Uncorrected and corrected audit misstatements

Audit misstatements include presentation and disclosure misstatements, including omissions.

Uncorrected audit misstatements

We did not identify differences 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.

- There was one corrected misstatement for an over-accrual related to recoveries. The adjustment decreased accounts payable and accrued liabilities by $815K, decreased expenses by $110K, and decreased accounts receivable by $705K.

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: Other required communications

Report	Representations of management
The conclusion of our audit is set out in our auditors' report attached to the consolidated financial statements.	We obtained from management certain representations upon the completion of the audit.

Audit Quality in Canada	Engagement terms
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 engagement letter and any subsequent amendments has been provided to the audit committee.

Appendix: 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
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.
Data Extraction & Analytics Tools	We evaluated the completeness of the journal entry population through a roll-forward of the entire GL.	The GL 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 GL 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.
Tangible Capital Assets - WIP transfers to asset additions	We utilized IDEA to ensure that asset additions to tangible capital assets recorded in the Citywide database transferred from work in progress are removed from work in progress completely.	We compared the asset additions listing to transfers out of work in progress and we investigated any significant asset additions that are not completely removed from work in progress. We did not identify any issues with the completeness of transfers out of work in progress as any remaining items were supported.
Tangible Capital Assets - Disposals	We utilized IDEA to verify that assets that were disposed of during the year were completely removed from the register of assets in the Citywide database.	Our comparison of the disposals listing to the asset register continued to include assets that were disposed of, however, consistent with our findings in the past, they were identified with unique asset IDs and were all reported at nil cost values, which results in effective elimination of costs from the assets reported in the Citywide database.

Tangible Capital Assets - Depreciation expense	We utilized IDEA to analyze depreciation expense on an asset level. We replicated the formula used to determine individual assets' annual amortization expense and recalculated an expected amount after verifying the appropriate inputs were used.	We did not find any issues in our recalculation of amortization expense compared to the amounts recorded by the City.
Holdback Completeness	We utilized D&A to evaluate whether construction holdbacks liabilities have been completely and consistently recorded for significant projects in work in progress at year-end.	We obtained the asset register for work in progress by project ID and the listing of contractor expenditures by business unit. We compared the holdbacks details from these two listings to identify significant projects that did not include a holdback. We did not find any issues with the completeness of holdbacks liabilities.
Cash Deposits Deferred Revenue	We utilized D&A to evaluate the year-over-year change (on a project level) for 100% of the population of projects for which cash deposits have been collected in the current and prior year.	We used the cash deposits reconciliation listing for current year and prior year. We extracted cash receipts details from the prior year listing and compared them to cash on hand in the current year listing to determine if the deferred revenue roll-forward was complete and accurately calculated. There were no issues with the completeness of prior year deposits in the records of the current year.

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	– 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.
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.

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.

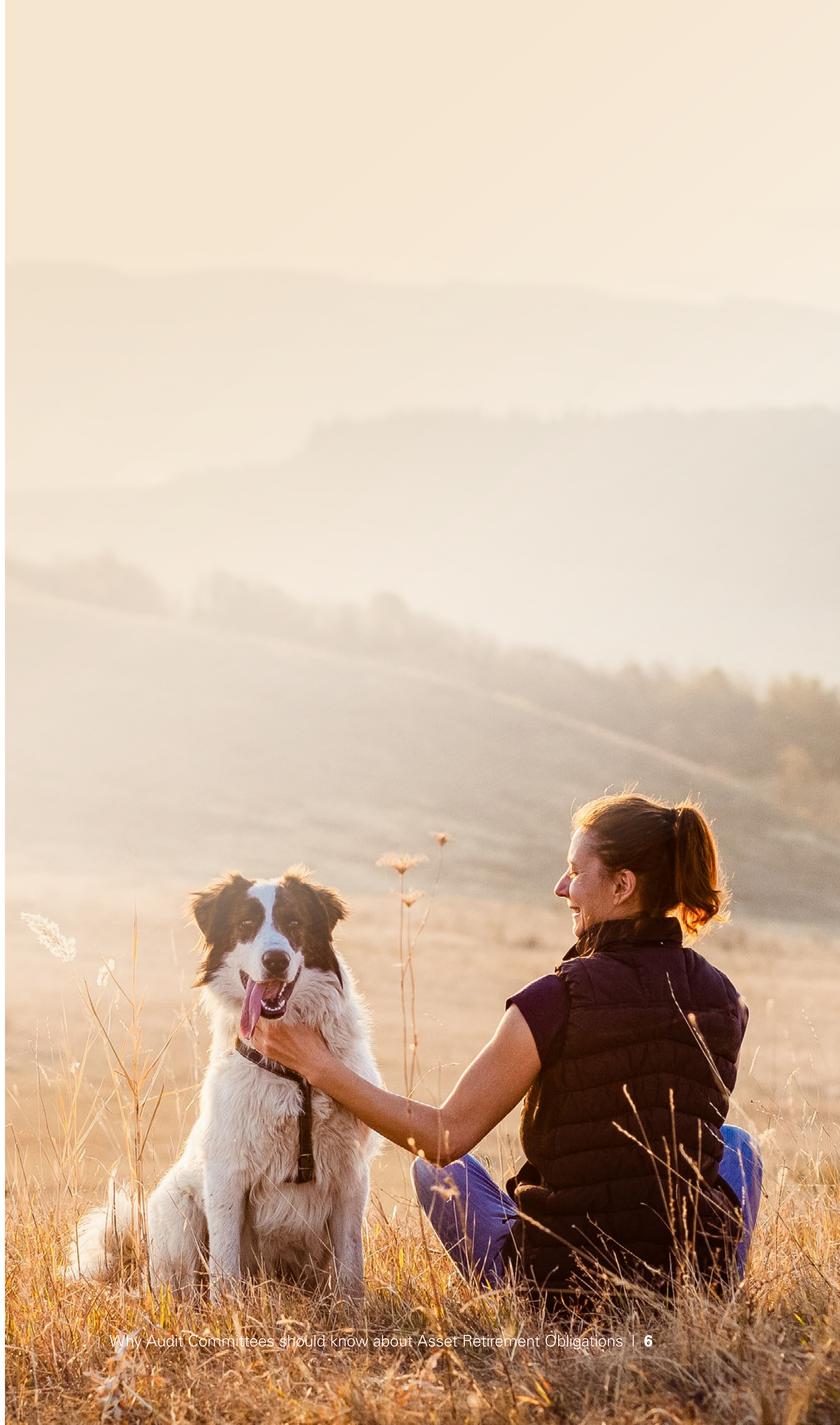
c. Completeness of assets

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.

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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

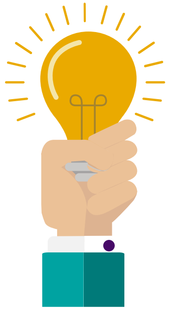
- ESG-related information is frequently disclosed outside of traditional financial statements whether in be in separate sustainability reports but also could be within the MD&A and/or AIF
- Such information can be in the form of key metrics as identified by management or specific qualitative information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

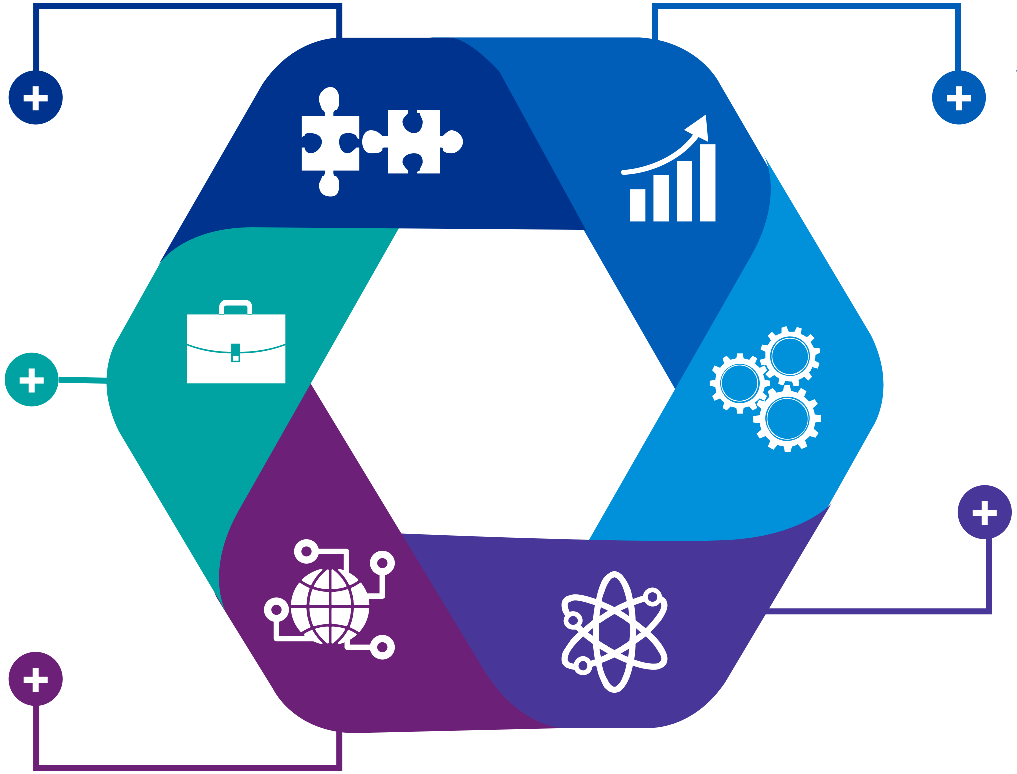
The Audit Committee will need to be involved in overseeing the development of policies, systems, processes, internal controls, governance and assurance for ESG data and reporting similar to that which is in place for collecting and disclosing financial information.

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

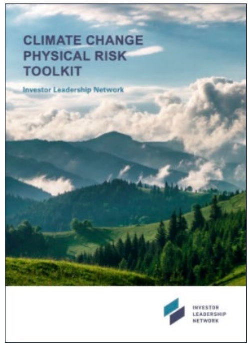
At KPMG we invest heavily in deepening our knowledge of ESG key trends, technical issues and differences among sectors. This ensures we remain at the forefront of our field.

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)

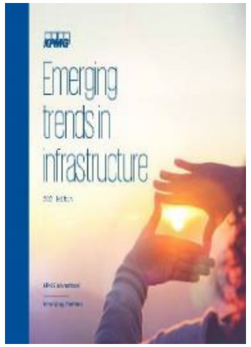
Climate Change Physical Risk Toolkit (2021)



Supporting Growth and Ensuring Care (2020)

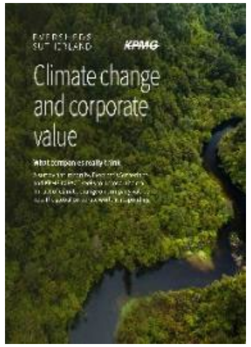
Business and the environment (2020)

Emerging Trends in Infrastructure 2021 Edition (2021)

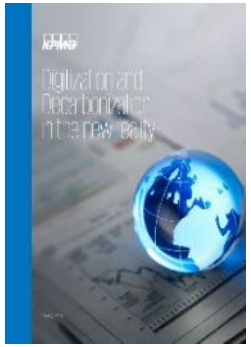


You can't go green without blue (2021)

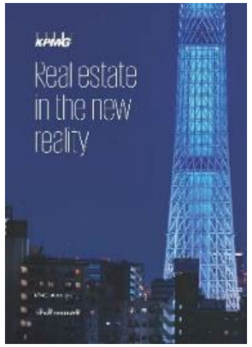
Climate change and corporate value (2020)



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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