

The City of Ottawa

2014 Financial Statement Audit Plan

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Members of the Audit Committee
The City of Ottawa

Dear Members of the Committee,

We look forward to discussing the current year audit plan for the City of Ottawa [the “City”]. We will outline the scope of our services, identify the EY team that will perform the audit, and present the key considerations that will affect the 2014 audit.

The audit is designed to express an opinion on the 2014 consolidated financial statements. We are currently completing the planning phase of our audit, and have aligned our procedures to consider the City’s current and emerging business risks and evaluate those that could materially affect the financial statements.

We appreciate that the City of Ottawa selected EY to perform its 2014 audit and are committed to executing an audit that is responsive to your needs and maximizes audit effectiveness, delivering the high quality you expect in the most efficient manner possible.

Very truly yours,

A handwritten signature in cursive script that reads "Ernst & Young LLP".

Chartered Professional Accountants
Licensed Public Accountants

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2014 EY services

Services and Deliverables

Audit and audit – related services

- Express an opinion, and report to the Audit Committee on the results of our audit of:
 - The consolidated financial statements of the City of Ottawa and the financial information of the City of Ottawa related entities and programs in accordance with municipal or other requirements.
- Issue a written consent for the use of our auditors' report in a continuous disclosure document, as required, and in accordance with the terms of our engagement agreement
- Issue a written communication to:
 - Management and the Audit Committee describing significant deficiencies in internal control identified during our audit, if any
 - Management and the Audit Committee describing other deficiencies in internal control identified during the audit that in our professional judgment, are of sufficient importance to merit their attention, if any
 - Management and the Audit Committee commenting on the results of the audit and addressing matters that we are required to communicate under our professional standards
- Issue a management letter including recommendations for improvements in controls and procedures, should any matters be noted.

Other Services

- Perform translation for the French consolidated financial statements and financial highlights included in the annual report of the City of Ottawa.

Executive Summary

**Significant
2014
considerations**

Audit timeline

- We will perform our interim procedures during the months of September through January and our year end procedures during the months of March through June. Refer to audit timetable included in this document.

Audit scope and strategy

- Our audit scope and strategy, including significant risks identified, for the 2014 audit is outlined in the “Areas of audit emphasis” section of this document.
-

Planning materiality

- At the conclusion of the audit, we formulate our opinion on the consolidated financial statements of the City as to their fair presentation in all material respects in accordance with Canadian public sector accounting standards.
- Our estimation of planning materiality requires professional judgment and necessarily takes into account qualitative as well as quantitative considerations.
- Based on the 2014 operating budget, we estimate the materiality for the audit of the 2014 consolidated financial statements to be \$43.7M (\$37.1M in 2013), which represents 1.5% of budgeted operating expenditures for the year ended December 31, 2014.
- The 2014 preliminary materiality level will be reviewed on an ongoing basis throughout our 2014 audit. Should actual results vary significantly from those forecast, the materiality level may be adjusted in order to recognize this change in circumstances.

Our Audit Plan

Audit approach

| Area | Comments |
|---|--|
| Our planned audit approach | |
| <p>For purposes of the audit of the financial statements, our audit scope is developed after considering the inherent and control risks and the effectiveness of the organization's internal controls. A variety of factors are considered when establishing the audit scope including size, specific risks, the volumes and types of transactions processed, changes in the business environment, and other factors.</p> | <p>Using our cumulative knowledge of the client's business, including the results of audit procedures in prior years and the knowledge gained from the current year's procedures that have been completed, we established a preliminary strategy for placing reliance on controls related to the flows of transactions and/or significant processes.</p> |
| <p>We distinguish between the following strategies:</p> <ul style="list-style-type: none">• Identify and evaluate controls (controls strategy)• Do not identify and evaluate controls (substantive strategy) | <p>Based on our planning, our intention is to test and rely on controls over the following significant accounts, in order to increase overall efficiency of the audit by reducing the nature, timing and/or extent of substantive procedures:</p> <ul style="list-style-type: none">• IT General Controls (ITGCs): We plan to audit the IT general controls of the SAP system in support of the financial statement audit of the City of Ottawa. Our procedures will include tests of change management, logical access, and IT operations.• Accounts payable, expenditures, and payroll expense processes. |
| | <p>Should the execution of our tests of controls result in exceptions, this may affect our planned reliance on such controls in conducting our year-end procedures. We will communicate to you any changes to our audit approach.</p> <ul style="list-style-type: none">• For the remaining significant accounts, we will take a substantive approach, as we believe that this will result in a more efficient audit of these accounts based on their nature. |

Our Audit Plan

Audit timetable

The following timetable outlines key activities of our 2014 audit plan:

| | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun |
|---|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Planning and risk identification | | | | | | | | | | | | |
| Strategy and risk assessment | | | | | | | | | | | | |
| Execution of audit procedures | | | | | | | | | | | | |
| Conclusion and reporting | | | | | | | | | | | | |

Our Audit Plan

Areas of audit emphasis

Our audit procedures emphasize testing areas with the highest risk of material misstatement (i.e. those accounts, contracts or transactions where we believe there is the greatest risk of material misstatement to the consolidated financial statements, whether due to error or fraud). We consider the effects of current market risk factors on the City, and also place emphasis on those areas requiring subjective determinations by management. We will reassess our risk assessment and other internal and external factors influencing the City throughout our audit, and communicate to you any changes to our initial plan, as necessary. Our areas of audit emphasis, including areas with identified significant risks, as well as our related planned audit procedures follow:

-
- Revenue recognition
 - Contingent liabilities
 - Investments and financial instruments
 - Employee benefit costs
 - Tangible capital asset
 - Commitments

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| <hr/> Revenue recognition <i>(PS 1200 - Financial Statement Presentation, PS 3100 - Restricted Assets and Revenues, PS 3410 - Government Transfers, PS 3510 - Tax Revenue)</i> <hr/> | |
| <ul style="list-style-type: none">• Taxation revenues are recorded in the period to which the assessment relates and reasonable estimates of amounts can be made.• Government transfers are recognized in revenue when they are authorized and when eligibility criteria have been met. Under certain circumstances, agreements may create a liability which is deferred until certain criteria are met.• Development charges must be used for specific purposes and are deferred and recognized in revenue in the period in which the resources are used for the purpose or purposes specified. | <ul style="list-style-type: none">• We will review the City's method for recognizing revenue and validate whether it is consistent with the prior year policy, the related accounting standards and industry practice.• We will walk through and update our understanding of the flow of transactions for taxation revenues, government transfer revenues and development charge revenues.• We will perform detailed analytics over recognized taxation revenues based on confirmations to be obtained from Municipal Property Assessment Corporation (MPAC) and based on municipal tax rates as approved by City Council.• We will validate the occurrence of government transfer and development charge revenues by performing test of details over a sample of transactions. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|---|---|
| Contingent Liabilities | |
| <i>(PS 3300 – Contingent Liabilities)</i> | |
| <ul style="list-style-type: none">• Accruals are recorded for regulatory and legal proceedings that arise in the ordinary course of business when likely and subject to reasonable estimation.• Many factors are considered in making an assessment of a contingency, including history and stage of litigation. Estimates are based upon consultation with legal counsel (in house and/or external). Legal fees are generally expensed as incurred. | <ul style="list-style-type: none">• We will perform a review of the contingent liabilities and assess management’s and legal counsel’s assumptions for each significant contingent liability identified.• We will confirm with both in-house and external legal counsel the completeness of the contingent liabilities reported by management. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|---|
| <hr/> | |
| Investments and financial instruments | |
| <i>(PS 3040 – Portfolio Investments)</i> | |
| <ul style="list-style-type: none">• The City values investments and financial instruments at amortized cost less amounts written off to reflect a permanent decline in value.• If fair value of investments is less than cost, the City must assess whether the impairment is considered other-than-temporary and, if so, recognize the other-than-temporary impairment in the statement of operations. | <ul style="list-style-type: none">• We will conduct substantive procedures on the amortized cost of the investments and perform confirmation procedures in order to verify the current market value of the investments.• Any significant difference between the market value of the investments and their book value will be assessed for impairment and to verify whether the decline in value is other-than-temporary. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|---|--|
| Employee benefit costs | |
| <i>(PS 3250 – Retirement Benefits, PS 3255 Post-employment benefits, compensated absences and termination benefits)</i> | |
| <ul style="list-style-type: none">• The liabilities and annual expense are determined by actuaries using assumptions (e.g., discount rate, wage rate changes, return on plan assets) established by the City’s management. The assumptions are based on the City’s own experience and forecasts for various attributes. The highly sensitive discount rate for the employee future benefits and pension agreements liability is determined by reference to the City’s cost of borrowing or plan asset earnings. | <ul style="list-style-type: none">• Our procedures include a review of the assumptions used by the specialist as the assumptions are highly sensitive (specifically the discount rate assumption).• We will review the 2014 valuation methods and assumptions used by the actuaries. We will conclude as to whether the methods used were in compliance with Canadian public sector accounting standards and assess whether the assumptions used are reasonable.• We will review the current pension obligation and pension asset for both pension plans and determine that the appropriate amounts are recorded in accordance with PS 3250. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|---|---|
| Tangible capital assets | |
| <i>(PS 3150 – Tangible Capital Assets)</i> | |
| <ul style="list-style-type: none">• Tangible capital assets are recorded at cost, which includes amounts that are directly attributable to acquisition, construction, development, or betterment of an asset. The costs, less residual value, of the tangible capital assets, excluding land, are amortized on a straight-line basis over their estimated useful lives. | <ul style="list-style-type: none">• A substantive audit of the additions, disposals and amortization will be performed during the year end audit. This substantive audit will include a review of the assumptions used for useful life, and depreciation methods.• We will review the write-down analysis performed on the tangible capital assets balance when conditions indicate that a tangible capital asset no longer contributes to the City's ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital asset is less than its net book value. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| Commitments | |
| <i>(PS 3390 – Contractual Obligations)</i> | |
| <ul style="list-style-type: none">The City discloses significant contractual obligations in the notes to the financial statements. | <ul style="list-style-type: none">We will continue to monitor the City’s activities related to commitments which may require disclosure in the notes to the financial statements. In particular, we will obtain management and legal representations regarding any commitments entered into during the year. |

Inquiries relating to matters relevant to the audit

We perform inquiries related to fraud and other matters to help inform our audit strategy and execution of our audit procedures. We would like to be informed of any matters of which you believe we should be aware, including, but not limited to:

- Your views about the risks of material misstatements due to fraud, including the risks of management override of controls
- Your knowledge of any actual, alleged or suspected fraud
- Your awareness of tips or complaints regarding the City's financial reporting (including those received through the audit committee's own "whistleblower" program, if any) and your response to such tips and complaints
- How you exercise oversight over the City's assessment of fraud risks and the establishment of controls to address these risks
- Your awareness of other matters, you believe, are relevant to the audit including, but not limited to, violations or possible violations of laws or regulations

When we identify a fraud risk, including a fraud risk that arises through or is associated with the risk of management override of controls, we perform audit procedures to address those risks. In addition to any specific responses related to the fraud risk, we also examine journal entries, review accounting estimates where there is significant judgment and complexity for management bias and evaluate the business rationale of significant unusual transactions as required by our professional standards.

EY services

Fair and transparent fees

| | 2014 estimated fees | 2013 actual fees |
|-----------------------------------|------------------------|---------------------|
| Audit fees ⁽¹⁾ | | |
| Audit of the financial statements | \$320,100 | \$417,699 |
| Total fees | \$320,100 | \$417,699 |

(1) Includes fees and expenses related to the audit of the consolidated annual results, subsidiaries, employee benefit plans and other municipal audit requirements, notwithstanding when the fees and expenses were billed or when the services were rendered.

Note: Services for which fees have not yet been approved are not included above.

Appendix A – Timing of required communications with audit committees

Timing of required communications

| | Communicate when event occurs | Communicate on a timely basis, at least annually |
|--|-------------------------------|--|
| Our responsibility under Canadian GAAS, including discussion of the type of opinion we are issuing | | X |
| Overview of planned scope and timing | | X |
| Other information in documents containing audited financial statements | | X |
| Major issues discussed with management in connection with initial or recurring retention | X | |
| Significant audit adjustments, including significant disclosure differences that merit the attention of those charged with governance | | X |
| Uncorrected misstatements, including significant disclosure differences that merit the attention of those charged with governance, considered by management to be immaterial | | X |
| Critical accounting policies and practices | | X |
| Our judgments about the quality of the City's accounting principles | | X |
| The adoption of, or a change in, an accounting policy | X | |
| Methods of accounting for significant unusual transactions and for controversial or emerging areas | X | |
| Sensitive accounting estimates | | X |
| All material alternative accounting treatments discussed with management | | X |
| Disagreements with management | X | |
| Consultations with other accountants | X | |
| Serious difficulties encountered in dealing with management when performing the audit | X | |

| | | |
|--|---|--|
| Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements | X | |
|--|---|--|

Timing of required communications

| | Communicate when event occurs | Communicate on a timely basis, at least annually |
|--|-------------------------------|--|
| Audit committee pre-approval of services | | X |
| Other material written communications with, and representations sought from management | | X |
| Communication of independence matters | | X |
| Fees and related disclosures | | X |
| Other findings or issues regarding the oversight of the financial reporting process | X | |
| Subsequent events | | X |
| Related-party transactions | | X |
| Matters related to component entities of the City | | X |
| All relationships between auditor and the City | | X |

Appendix B – Accounting and auditing developments

Accounting & auditing developments

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|--|---|---|
| <p>Financial Instruments, Foreign Currency Translation, and Financial Statement Presentation (PS3450, PS2601, PS1201 and PS3041)</p> | <ul style="list-style-type: none"> • PSAB approved two new standards, Section PS 3450, <i>Financial Instruments</i>, and Section PS 2601, <i>Foreign Currency Translation</i>, as well as related financial statement presentation changes to <i>Financial Statement Presentation</i>, Section PS 1200. • The Board believes that this recognition standard is a significant evolution in the accounting standards for financial instruments in the public sector, as it requires the accounting recognition of derivatives while addressing constituent concerns by isolating the volatility associated with re-measurement gains and losses from the operating statement. • In fiscal 2012, amendments to PS3040 were issued in order to conform to the new PS3450. This resulted in the issuance of PS3041 and the withdrawal of PS3030 – temporary investments. Both temporary and portfolio investments are covered in the new PS3041 and should be accounted for as portfolio investments. In addition, pooled investment funds are now included within the scope of PS3041. PS3041 is effective upon adoption of PS3450. • PSAB completed its review of the application of Section PS 2601, <i>Foreign Currency Translation</i>, and Section PS 3450, <i>Financial Instruments</i>, for governments, and | <ul style="list-style-type: none"> • The City will need to assess the impact of these new standards on its consolidated financial statements. The new accounting standards need to be implemented in the City of Ottawa’s financial statements in the fiscal year ending December 31, 2017 or earlier if deemed appropriate. |

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|---|--|---|
| | <p>confirmed that the principles are fundamentally sound.</p> <ul style="list-style-type: none"> • The request for additional time to implement the standards was supported. PSAB views the extension as an opportunity to address transitional issues and concerns prior to the effective date. • In December 2013, PSAB approved an amendment to the transitional provisions to extend the effective date to April 1, 2016 from April 1, 2015.. | |
| <p>Liabilities for Contaminated Sites (PS3260)</p> | <ul style="list-style-type: none"> • PSAB approved Section PS 3260, Liabilities for Contaminated Sites, as a final standard. • This new standard is effective for fiscal years beginning on or after April 1, 2014. If application of the Section results in a change in accounting policy, Accounting Changes, Section PS 2120, applies. Earlier adoption is permitted. • The standard requires that a liability for remediation of contaminated sites should be recognized when an environmental standard exists, the contamination exceeds the environmental standard, the government is directly responsible or accepts responsibility for remediation of the contaminated site, and a reasonable estimate of the amount can be made. • Uncertainty about the existence of contamination does not eliminate the need to determine whether a liability exists and its recognition. • The liability should be reviewed at | <ul style="list-style-type: none"> • The new standard related to liabilities for contaminated sites should be reviewed by the City of Ottawa in order to assess its impact on the financial statements, and related accounting in the 2015 fiscal year or earlier if deemed appropriate. |

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|--|---|---|
| | <p>each reporting date. Any changes to the liability should be recognized when the revisions are made.</p> | |
| <p>Other PSAB projects:</p> | <ul style="list-style-type: none"> The PSAB decision summary is prepared for information purposes only and information reflects only the current status which could change after further deliberations. | <ul style="list-style-type: none"> There is no current impact on the consolidated financial statements of the City of Ottawa |
| <p>Related party transactions</p> | <ul style="list-style-type: none"> The Board has issued a Re-exposure Draft that proposes standards dealing with related party disclosures and inter-entity transactions. Stakeholders are encouraged to submit their comments, on the form provided, by September 15, 2014. | <ul style="list-style-type: none"> Management should follow the progress of the exposure draft in this area in order to further identify any required changes to the financial statements in future periods. |
| <p>Asset retirement obligations</p> | <p>PSAB reviewed a draft statement of principles, “Retirement Obligations,” and requested that the document clarify the difference between retirement and replacement or renewal of tangible capital assets. PSAB approved the</p> | |

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|--------------------------------------|---|--|
| | <p>following proposed principles:</p> <ul style="list-style-type: none"> • Retirement obligations associated with tangible capital assets include those resulting from legal, constructive and equitable obligations. • Retirement costs increase the carrying amount of the related tangible capital asset or a component thereof and are expensed in a rational and systematic manner. • Retirement obligations would be measured using best estimate methodologies. • Subsequent remeasurement of the retirement obligation liability result in either a change in the carrying amount of the related tangible capital asset or a component thereof, or an expense, depending on the nature of the remeasurement and whether the asset remains in productive use. • Retirement obligations associated with tangible capital assets include post-retirement operation, maintenance and monitoring. | |
| <p>Restructurings</p> | <p>PSAB approved an exposure draft, “Restructuring Transactions,” proposing standards on accounting for and reporting assets and liabilities transferred in restructuring transactions by both transferors and recipients. The proposals would apply to restructuring transactions among entities under common control.</p> <p>PSAB has issued an Exposure Draft</p> | |

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|---|---|---|
| | that proposes a new standard on restructuring transactions. Stakeholders are encouraged to submit their comments, on the form provided, by November 28, 2014. | |
| Revenue | PSAB discussed issues identified by staff based on a preliminary review of responses to its Statement of Principles. PSAB noted that further research on these issues will be required. The project timeline will be extended as a result. | |
| Assets | <p>PSAB approved an exposure draft, “Assets, Contingent Assets and Contractual Rights,” after a review of the responses to its Statement of Principles. There was general support to the proposed principles and guidance.</p> <p>PSAB has issued an Exposure Draft that proposes three new standards. Stakeholders are encouraged to submit their comments, on the form provided, by November 3, 2014.</p> | |

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