



The City of Ottawa
2012 financial statement audit plan



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Members of the Audit Sub-Committee
Corporation of the City of Ottawa

November 29, 2012

Dear Members of the Committee,

We are providing information related to the current year audit plan for the City of Ottawa. This document outlines the scope of our services and the key considerations that will affect the 2012 audit.

The audit is designed to express an opinion on the 2012 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 consolidated financial statements.

We appreciate that the City of Ottawa selected Ernst & Young to perform its 2012 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.

Chartered Accountants
Licensed Public Accountants

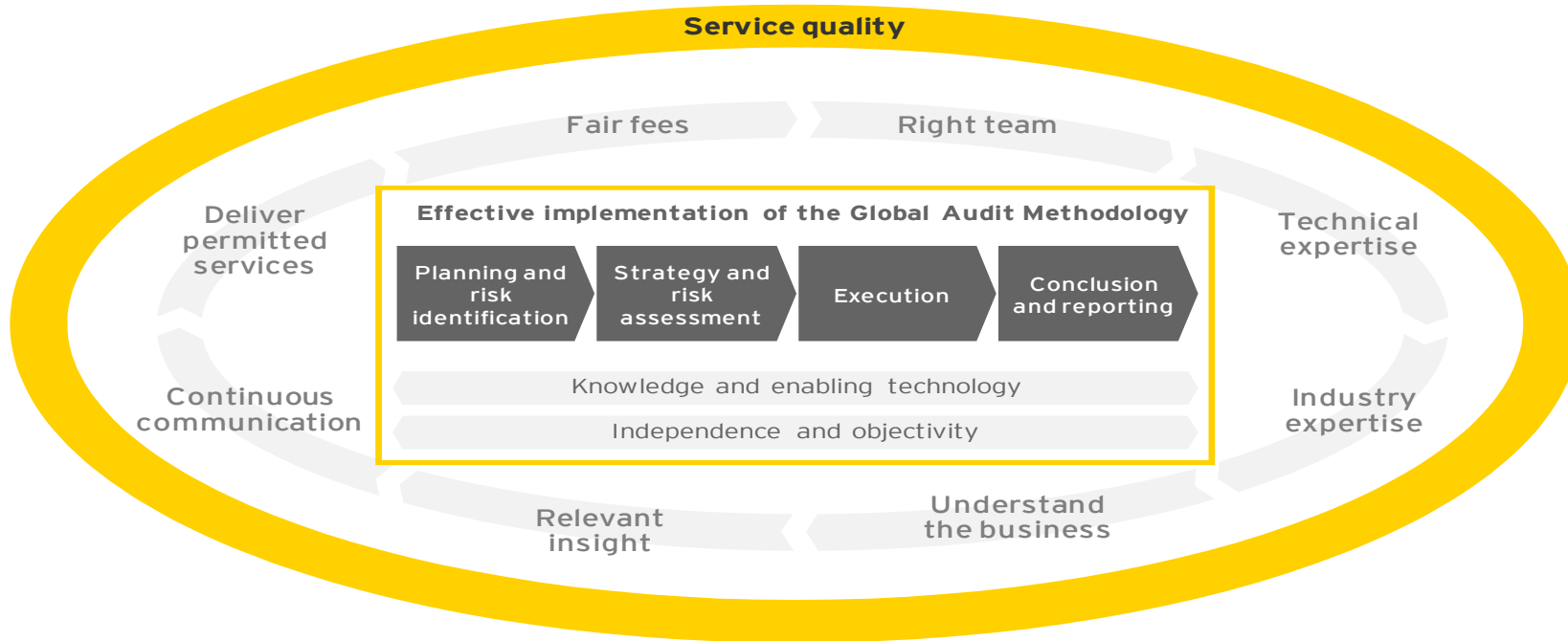
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Quality In Everything We Do

Agenda

- ▶ Our client service commitment to the City of Ottawa
- ▶ 2012 deliverables
- ▶ Responsibility for financial statements
- ▶ Global audit methodology
 - ▶ Overview of the audit process
 - ▶ Materiality
 - ▶ Internal control strategy
 - ▶ Audit approach
 - ▶ Areas of emphasis and audit responses
 - ▶ Accounting and auditing developments
 - ▶ Fraud considerations and the risk of management override
 - ▶ Calendar of Audit Events
 - ▶ Client Service Team
 - ▶ Fair and Transparent Fees
- ▶ Appendix A – Timing of required communications

Our client service commitment to the City of Ottawa



Our service commitment

Ernst & Young is committed to delivering consistent high-quality client service to the City of Ottawa. Our service commitment is centered on our most critical objective of performing a high-quality audit of the City’s financial statements. Additionally, we strive to provide “Quality In Everything We Do” and recognize that service quality extends well beyond execution of our audit methodology. It is driven by the quality of our team and the effectiveness and value of our communications with management and the audit committee. Our overall service commitment to the City of Ottawa is depicted above and is aligned with our Ernst & Young Assurance Service Delivery Approach.

2012 deliverables

	Audit deliverables
Opinions	<ul style="list-style-type: none"> ▶ Express an opinion on the consolidated financial statements of the City of Ottawa ▶ Express opinions on 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 letter
Written communication	<ul style="list-style-type: none"> ▶ Issue a written communication to management and the Audit Sub-Committee describing significant deficiencies in internal control identified during our audit, or other deficiencies in internal control that in our professional judgment, are of sufficient importance to merit their attention. ▶ Issue a management letter that provides our recommendations regarding internal controls and opportunities for improvement or efficiency, based on observations made during the course of our audit, if necessary ▶ Issue a written communication to management and the Audit Sub-Committee that comments on the results of the audit and addresses matters that we are required to communicate under our professional standards.
Other services	<ul style="list-style-type: none"> ▶ Issue a written communication to the committee about independence matters in accordance with Canadian Professional Standards ▶ Perform translation for the French consolidated financial statements and financial highlights included in the annual report of the City of Ottawa

Responsibility for financial statements

► Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

► Auditors' responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We will conduct our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we will consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Global audit methodology

Overview of the audit process

Ernst & Young audit process



Important planning matters for audit committee consideration

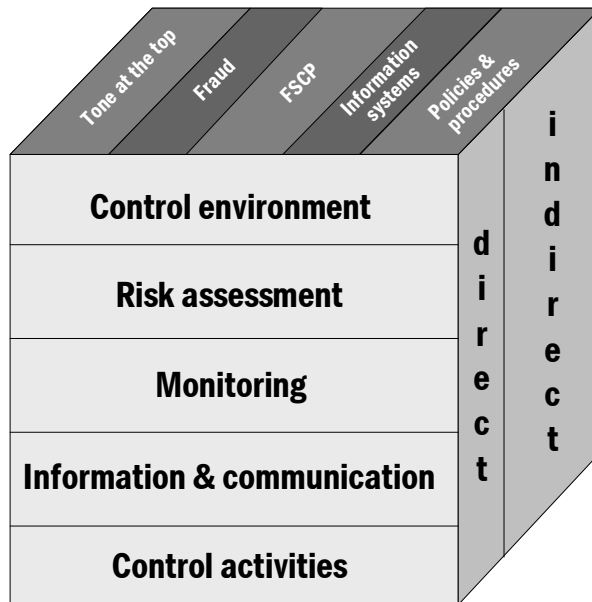
- ▶ Materiality
- ▶ Internal control strategy
- ▶ Audit approach
- ▶ Areas of emphasis and audit responses
- ▶ Accounting and auditing developments
- ▶ Fraud considerations and the risk of management override

Materiality

- ▶ At the conclusion of the audit, we formulate our opinion on the consolidated financial statements of the City of Ottawa as to their fair presentation in all material respects in accordance with Canadian generally accepted accounting principles.
- ▶ Our estimation of planning materiality requires professional judgment and necessarily takes into account qualitative as well as quantitative considerations.
- ▶ Based on the 2012 operating budget, we estimate the materiality for the audit of the 2012 financial statements to be \$34.2M (\$26.3M in 2011), which represents 1.25% of budgeted operating expenditures for the year ended December 31, 2012. The 2012 preliminary materiality level will be reviewed on an ongoing basis throughout our 2012 audit. Should actual results vary significantly from those forecasted, the materiality level may be adjusted in order to recognize this change in circumstances.

Internal control strategy

Entity-level controls



- ▶ Our view of entity-level controls encompasses the following:
 - ▶ Entity-level controls can exist within each of the five components of internal control
 - ▶ We maximize the opportunity to identify entity-level controls important to our audit by considering those entity-level controls that exist within the City's "tone at the top," anti-fraud programs and controls, the financial statement close process, centralized processing systems, and policies and procedures
 - ▶ We recognize that entity-level controls can either be indirectly or directly related to the relevant assertions of significant accounts
 - ▶ We have assessed internal controls at the entity level to be effective

Examples of the City's indirect entity-level controls:

- ▶ Audit Sub-Committee oversight of external financial reporting
- ▶ City Council reviews and approves the City's strategic plan
- ▶ Employee Code of Conduct
- ▶ Auditor General provides internal audit services for the City and reports directly to City Council

Examples of the City's direct entity-level controls:

- ▶ Business unit performance is assessed by comparing actual expenditures to budget
- ▶ Financial Services Unit managers are responsible for the activity within their departments
- ▶ There is a segregation of duties that exists between key processes such as initiating, processing and recording a transaction

Internal control strategy

IT environment

Control type	Control areas	Key audit procedures	
<p>Detect</p> <p>Prevent</p> <p>IT general controls</p>	<p>IT-dependent manual (Both manual and automated aspects)</p>	<p>Evaluate controls over the completeness and accuracy of computer-produced information (i.e., source of the information and management’s controls to ensure information is complete and accurate), also considering effectiveness of IT General Controls (ITGCs).</p>	
	<p>Application (Edit and validation checks, calculations, interfaces, authorizations)</p>	<p>Application controls are tested directly. Opportunity exists to alter the extent of testing if ITGCs are tested and determined to be effective.</p>	
	<p>Manage change (Only appropriately authorized, tested, and approved changes are made to applications, interfaces, databases, and operating systems)</p>	<p>Logical access (Only authorized persons have access to data and applications and that they can perform only specifically authorized functions)</p>	<p>ITGCs support the continued functioning of automated aspects of prevent and detect controls and contribute to the reliance on electronic audit evidence. For the applications for which we plan to rely on ITGCs, we identify, understand, walk through, test and evaluate relevant ITGCs.</p>
	<p>Other ITGCs (Proper data backup and recovery, programs executed as planned, deviations from scheduled processing are identified and resolved in a timely manner)</p>		

Audit approach

Area	Comments
<p>Our planned audit approach</p> <p>Using our cumulative knowledge of the City of Ottawa's organization, including the results of audit procedures in prior years and the knowledge gained from the current year's procedures that have been completed, we establish a preliminary strategy for placing reliance on controls related to the flows of transactions and/ or significant processes.</p> <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>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>All accounts of the City were determined to be significant based on preliminary materiality determinations, with the exception of prepaid expenses.</p> <p>Our intention based on our planning, 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"> ▶ Accounts payable and expenditures (excluding payroll) - we plan to audit the IT general controls of 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. <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> <p>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.</p>

Areas of emphasis and audit responses

Area and accounting policy	Comments, risk considerations and audit responses
<p>Revenue recognition (PS 1200 - Financial Statement Presentation)</p>	
<p>Taxation revenues are recorded at the time tax billings are issued.</p>	<ul style="list-style-type: none"> ▶ The City's method for recognizing revenue is consistent with the prior year policy and industry practice. ▶ We will conduct substantive procedures on the tax revenues including a verification of the municipal tax rates used in the calculations, as approved by City Council.
<p>Contingent Liabilities (PS 3300 - Contingent Liabilities)</p>	
<p>Accruals are recorded for regulatory and legal proceedings that arise in the ordinary course of business when likely and subject to reasonable estimation.</p> <p>Many factors are considered in making an assessment of a contingency, including history and stage of litigation. Estimates are based upon consultation of legal counsel (in-house and/or external). Legal fees are generally expensed as incurred.</p>	<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.

Areas of emphasis and audit responses (cont'd)

Area and accounting policy	Comments, risk considerations and audit responses
<p>Investments and Financial Instruments (PS 3040 - Portfolio Investments)</p> <p>The City of Ottawa values investments and financial instruments at amortized cost less amounts written off to reflect a permanent decline in value.</p> <p>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 earnings.</p>	<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.
<p>Employee Benefit Costs (PS 3250 - Retirement Benefits)</p> <p>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 pension liability is determined by reference to the City's cost of borrowing or plan assets earnings.</p>	<ul style="list-style-type: none"> ▶ The assumptions (specifically the discount rate assumption) are highly sensitive, thus our procedures include a review of the assumptions used by the specialist. ▶ We will review the 2012 valuation methods and assumptions used by the actuaries. We will conclude as to whether the methods used were in compliance with Canadian generally accepted accounting principles 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 <p style="text-align: center;">ERNST & YOUNG Quality In Everything We Do</p>

Areas of emphasis and audit responses (cont'd)

Area and accounting policy	Comments, risk considerations and audit responses
<p>Tangible Capital Asset Reporting (PS 3150 - Tangible Capital Assets)</p> <p>The City records its tangible capital assets in accordance with PS 3150.</p>	<ul style="list-style-type: none"> ▶ A substantive audit of the additions, deletions and amortization will be performed during the year end audit. This substantive audit also includes a review of the assumptions used for useful life, and depreciation methods. ▶ An impairment analysis will also be performed on the Tangible Capital Assets balance if events indicate that one is required.
<p>Commitments (PS 3390 - Contractual Obligations)</p> <p>The City discloses significant contractual obligations in the notes to the financial statements.</p>	<ul style="list-style-type: none"> ▶ We will continue to monitor the City of Ottawa'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 legal commitments entered into during the year.

Accounting and auditing developments

Accounting and auditing developments	Summary	Effect on the City of Ottawa consolidated financial statements
<p>Amendments resulting from changes to the Introduction to Public Sector Accounting Standards</p>	<p>► Recent amendments to the Introduction to Public Sector Accounting Standards have resulted in directing some government organizations to the standards in the CICA Public Sector Accounting (PSA) Handbook. Government organizations that previously followed the CICA Handbook - Accounting (now Part V of that Handbook) will be transitioning to the PSA Handbook. In particular, government business enterprises were directed to adopt IFRSs and other government organizations were directed to follow either IFRSs or the Public Sector Accounting (PSA) Handbook. PSAB also determined that not-for-profit organizations controlled by a government (ie. government not-for-profit organizations or GNFPs) should follow the PSA Handbook. To ease the transition PSAB introduced PSA specific standards that GNFPs can elect to follow. These standards are included in the PSA Handbook as sections PS4200 to PS4270 (ie. the PS 4200 series).</p>	<p>► Management will need to assess the impact of the transition to new accounting standards for entities consolidated into the financial statements of the City of Ottawa in the years the related entities convert to new standards.</p>

Accounting and auditing developments (cont'd)

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 transitional provisions were a key issue during the deliberations. For governments, the new standards are effective for fiscal years beginning on or after April 1, 2015. Earlier adoption is permitted. ▶ 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. 	<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, 2016 or earlier if deemed appropriate. ▶ Government organizations within the government entity must adopt the standard for fiscal years starting on or after April 1, 2012.

Accounting and auditing developments (cont'd)

Accounting and auditing developments	Summary	Effect on the City of Ottawa consolidated financial statements
<p>Government Transfers and Tax Revenues (PS3410 and PS3510)</p>	<ul style="list-style-type: none"> ▶ Revenues are defined in the Public Sector Accounting (PSA) Handbook in Section PS 1000, <i>Financial Statement Concepts</i>, as “increases in economic resources, either by way of increases of assets or decreases of liabilities, resulting from the operations, transactions and events of the accounting period.” ▶ Section PS 1200, <i>Financial Statement Presentation</i>, addresses recognition and disclosure of revenues in general terms. ▶ The PSA Handbook has two standards that address two major sources of government revenues, government transfers (Section PS 3410 - revised version effective fiscal years starting after April 1, 2012) and tax revenue (Section PS 3510 - new standard effective fiscal years after April 1, 2012). Other sources of revenues of governments and government organizations include fines and penalties, royalties, license fees, other fees, sales and rental, etc. 	<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, 2013.

Accounting and auditing developments (cont'd)

Accounting and auditing developments	Summary	Effect on the City of Ottawa consolidated financial statements
<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. ▶ 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 each reporting date. Any changes to the liability should be recognized when the revisions are made. 	<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 (cont'd)

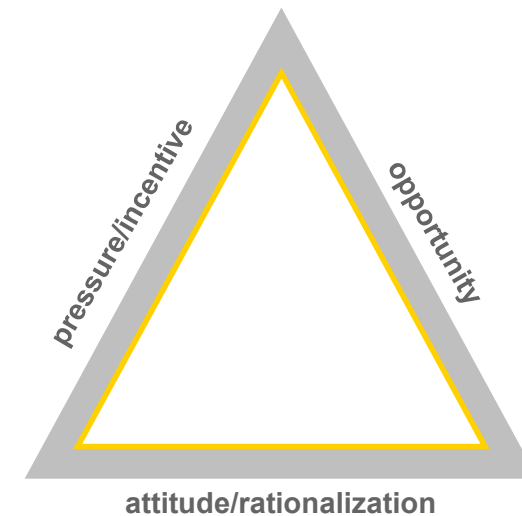
Accounting and auditing developments	Summary	Effect on the City of Ottawa consolidated financial statements
Other PSAB projects	The PSAB decision summary is prepared for information purposes only and information reflects only the current status which could change after further deliberations.	▶ There is no current impact on the consolidated financial statements of the City of Ottawa
Related party transactions	PSAB approved an exposure draft on this topic. The proposals would require disclosure of sufficient information about transactions between related parties to help users assess their effect on the financial position and financial performance.	▶ 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.
Financial Instruments – Restricted Assets and Revenues	PSAB approved an exposure draft proposing amendments to certain paragraphs in Section PS 3450, <i>Financial Instruments</i> . The amendments ensure that the reporting of income on externally restricted assets that are financial instruments aligns with the requirements in Section PS 3100, <i>Restricted Assets and Revenues</i> . The proposed amendments also address transitional issues that can arise when Section PS 3450 is adopted.	
Impairment of Non-Financial Assets	PSAB approved a project proposal. The project will focus on addressing the impairment of tangible capital assets that provide service benefits. Deferred maintenance issues will also be considered. The project will define impairment, and provide guidance on assessment, recognition, measurement and disclosure of impairment losses.	
Asset retirement obligations	PSAB approved a project proposal. This project will address the reporting of legal obligations associated with the retirement of long-lived tangible capital assets currently in productive use.	

Fraud considerations and the risk of management override

In accordance with Canadian professional standards, we are responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or by fraud.

Our audit procedures will include: brainstorming, gathering information to facilitate the identification of fraud risks and performing procedures in the areas where fraud risks are identified including performing procedures required by our professional standards, designed to address the risk of management override (including examining journal entries, reviewing accounting estimates and evaluating the business rationale of significant unusual transactions).

- ▶ We evaluate the risk of management override using the fraud triangle which includes rationalization, opportunity, and incentive and consider the actions management has taken to respond to those risks.
- ▶ We consider, among other things:
 - ▶ Code of conduct/ethics
 - ▶ Effective and independent oversight by audit committee
 - ▶ Process for dealing with whistle-blower allegations
 - ▶ Adequacy of internal audit activity
 - ▶ Entity's risk assessment processes
 - ▶ Role and oversight responsibilities of the audit committee:
 - ▶ Management's assessment of the risks of fraud
 - ▶ Programs and controls to mitigate the risk of fraud
 - ▶ Process for monitoring multiple locations for fraud
 - ▶ Management communication to employees on its views on business practices and ethical behavior



Occupational Fraud and Abuse, by Joseph T. Wells, CPA, CFR
(Obsidian Publishing Co, 1997);
Fraud Examination, by W. Steve Albrecht (Thomson South-Western Publishing, 2003)

Calendar of Audit Events

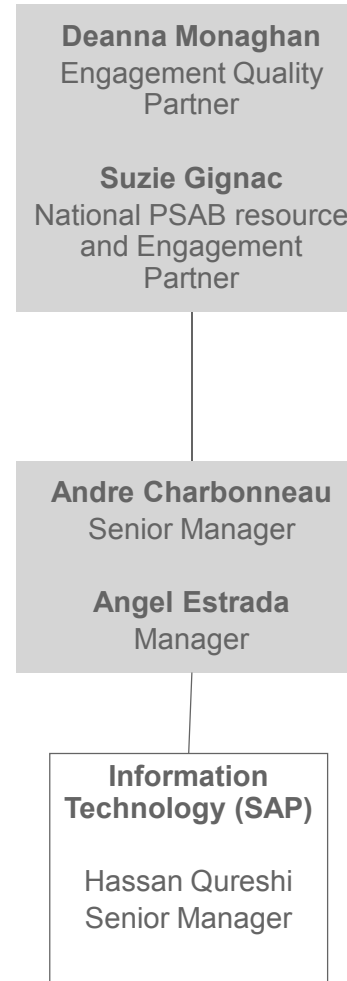
Assurance calendar

	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Client events												
Audit Plan												
▶ Develop audit plan												
▶ Present audit plan												
Interim Audit – Part 1												
▶ ITGC testing												
▶ Audit control testing												
Interim Audit – Part 2												
▶ Audit control testing												
▶ Interim audit procedures												
Year End Audit												
▶ Year end audit												
▶ Wrap up and reporting												
▶ Financial statements to Council												

Client service team

Experience highlights

- ▶ Over 10 years of experience on the City of Ottawa audit
- ▶ Experience serving numerous public sector and not-for-profit organizations
- ▶ Extensive knowledge of PSAB and the public sector
- ▶ Member of PSAB asset task force
- ▶ Member of 2011 and 2012 PSAB conference advisory committee



Fair and transparent fees

2012 audit fee summary

	2012 budgeted fees	2011 actual fees	Explanatory notes
	\$	\$	
Audit fees (1)			
Total audit related fees	461,900	547,250	
Total audit related fees	461,900	547,250	

1) Includes fees and expenses related to the audit of the consolidated annual results, subsidiaries, employee benefit plans and other municipal audit requirements.

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

Appendix A

Timing of required communications

Timing of required communications

	Communicate when event occurs	Communicate on a timely basis, at least annually
Communications required on all audits		
Audit and non-audit services provided to the entity and related entities		X
Our responsibility under GAAS, including other information in documents containing audited financial statements		X
Overview of planned scope and timing		X
A summary of the audit approach		X
Communication of independence matters		X
Material alternative accounting treatments discussed with management		X
Representations the auditor requests from management		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
Non-trivial recorded audit adjustments		X
Uncorrected misstatements, including significant disclosure differences that merit the attention of those charged with governance, considered by management to be immaterial		X
Our judgments about the quality of the City's accounting principles		X
Disagreements with management	X	
Consultations with other accountants	X	
Serious difficulties encountered in dealing with management when performing the audit	X	

Timing of required communications

	Communicate when event occurs	Communicate on a timely basis, at least annually
Communications required on all audits (cont'd)		
The adoption of, or a change in, an accounting principle	X	
Methods of accounting for significant unusual transactions and for controversial or emerging areas, and their effect	X	
Sensitive accounting estimates		X
Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements	X	
Significant deficiencies in internal control over financial reporting		X
Other material written communications with, and representations sought from management		X
Other findings or issues regarding the oversight of the financial reporting process	X	
Subsequent events		X
Related party transactions identified that are not in the normal course of operations		X
Matters relating to component entities of the City		X
All relationships between auditor and the Entity		X
Additional communications required on audits of public clients		
Fees and Related Regulatory disclosures		X
Audit committee pre-approval of services		X
Critical accounting policies and practices		X
Use of the Audit Report and our responsibilities for other information in documents containing the audited financial statements		X

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