

The City of Ottawa

2020 Financial Statement Audit Plan

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November 24, 2020

Members of the Audit Committee
The City of Ottawa

Dear Members of the Audit Committee,

We look forward to discussing the current year audit plan for the City of Ottawa [the "City"] at your meeting on November 24, 2020. We will outline the scope of our services, identify the EY team scheduled to perform the audit, and present the key considerations that will affect the 2020 audit.

The audit is designed to express an opinion on the 2020 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 EY to perform its 2020 audit and we 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,

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

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Licensed Public Accountants

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2020 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 communication to:
 - Management and the Audit Committee describing significant deficiencies in internal controls identified during our audit, if any
 - Management and the Audit Committee describing other deficiencies in internal controls 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 of the French consolidated financial statements.

Executive Summary

2020 considerations

Audit strategy

- Our audit strategy is risk-based and our areas of audit emphasis for the 2020 audit are outlined in the “Areas of audit emphasis” section of this document.
- As in prior years, we plan to rely on controls over certain systems and processes as part of our audit strategy.

Audit materiality

- Materiality has been set at \$93.9M and is based on 2.5% of the 2020 budgeted operating expenditures.

Audit timeline

- We will perform our interim procedures during the months of October 2020 through January 2021 and our year-end procedures during the months of April and May 2021.

Audit team

- The audit team will be led by Suzie Gignac and supported by Deanna Monaghan as Engagement Quality Reviewer and Mita Meyers as senior manager.

Independence

- We are independent and have extensive quality control and conflict checking processes in place to maintain our independence.
-

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 2020 operating budget, we estimate the materiality for the audit of the 2020 consolidated financial statements to be \$93.9M, which represents 2.5% of budgeted operating expenditures for the year ended December 31, 2020.
- After setting materiality, we also calculate performance materiality which is set to reduce to an appropriately low level, the probability that the aggregate of uncorrected/undetected misstatement exceeds materiality in a particular account or in the consolidated financial statements as a whole.
- Based on our understanding of the City, we would anticipate setting performance materiality at 75% of materiality or \$70M.

- The 2020 preliminary materiality level will be reviewed on an ongoing basis throughout our 2020 audit. Should actual results vary significantly from those budgeted, the materiality level may be adjusted in order to recognize this change in circumstances.
- Testing is performed at thresholds well below the audit materiality level in order to perform sufficient audit work to provide an opinion on the financial statements.

Our Audit Plan

Audit approach

| Area | Comments |
|---|---|
| <hr/> Our planned audit approach <hr/> | |
| <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 City's business, including the results of audit procedures in prior years and the knowledge gained from the current year procedures completed to-date, we have established a preliminary strategy for placing reliance on controls related to the flows of certain transactions and/or significant processes.</p> <p>Based on our planning, our intention is to test and rely on controls in the following areas, in order to increase overall efficiency of the audit by reducing the nature, timing and/or extent of substantive procedures:</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) | <ul style="list-style-type: none"> • IT General Controls (ITGCs): We plan to audit the IT general controls related to the SAP system and the changeover from Markview to ARIBA 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, cash disbursements, and payroll expense process. |
| | <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>We plan to integrate data analytics as part of our audit approach, through the use of our EY Helix suite of data analytics tools. Use of data analytics allows us to analyze greater quantities of data, enhance our understanding of the City's</p> <hr/> |

| Area | Comments |
|------|---|
| | <p>business and processes, design procedures that are better targeted towards the risks, and deliver more value from our audit. We intend to apply data analytics techniques over journal entry testing for management override and any accounts where data analysis will provide insightful audit results.</p> <p>For the remaining significant accounts, we will take a substantive approach, as we believe this will result in a more efficient audit of the related accounts based on their nature.</p> |

Our Audit Plan

Audit timetable

The following timetable outlines key activities of our 2020 audit plan:

| | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun |
|--------------------------|--------|--------|--------|--------|--------|--------|-----|--------|--------|--------|--------|
| Scope and strategy | Yellow | Yellow | Yellow | | | | | | | | |
| Execution | | | Yellow | Yellow | Yellow | Yellow | | Yellow | Yellow | Yellow | |
| Conclusion and reporting | | | | | | | | | | Yellow | Yellow |

Our Audit Plan

Areas of audit emphasis

Our audit procedures emphasize testing areas with the highest risk of misstatement (e.g., those accounts, contracts or transactions where we believe there is the greatest risk of material misstatement to the financial statements, whether due to error or fraud, including disclosure items). We consider the effects of current risk factors on the City, and emphasis is also placed on those areas requiring difficult, subjective, or complex determinations by management with heightened professional skepticism. Accordingly, our audit procedures are planned to focus on the following areas:

- Impact of COVID-19
- Revenue recognition
- Contingent liabilities
- Investments
- Employee benefit costs
- Tangible capital assets
- Commitments

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| Impact of COVID-19 | |
| <ul style="list-style-type: none">The COVID-19 pandemic has disrupted operations and will impact accounting and audit considerations. | <ul style="list-style-type: none">We will assess the impact of COVID-19 on the financial statements; in particular, in areas related to estimates and valuations.We will consider the guidance recently issued by the Public Sector Standards Board (PSAB) of <i>application of Public Sector Accounting Standards (PSAS) to COVID-19-related financial reporting issues</i> as we perform our audit of the financial statements of the City of Ottawa. |
| Revenue recognition <i>(PS 1200 - Financial Statement Presentation, PS 3100 - Restricted Assets and Revenues, PS 3410 - Government Transfers, PS 3510 - Tax Revenue)</i> | |
| <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 specified purpose(s). | <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, development charge revenues and fees and user charges revenues.We will perform substantive analytical procedures over the water and sewer and public transit user fee groups.We will perform test of details over the revenue for government transfers and development charges |

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| <ul style="list-style-type: none"><li data-bbox="272 254 760 394">• Fees and user charges are recognized when the activity is performed or when the services are rendered. | and review new contracts and agreements. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| <p data-bbox="203 415 779 457">Contingent Liabilities</p> <p data-bbox="203 457 779 508"><i>(PS 3300 - Contingent Liabilities)</i></p> | |
| <ul data-bbox="259 508 779 1312" style="list-style-type: none"> <li data-bbox="259 508 779 745">• Accruals are recorded for regulatory and legal proceedings that arise in the ordinary course of business when likely and subject to reasonable estimation. <li data-bbox="259 745 779 1312">• 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 data-bbox="844 508 1446 1312" style="list-style-type: none"> <li data-bbox="844 508 1446 714">• We will walk through the contingent liability identification and recognition process to update our understanding of the process and review controls within. <li data-bbox="844 714 1446 913">• We will perform a review of the contingent liabilities and assess assumptions used by management and legal counsel for each significant contingent liability. <li data-bbox="844 913 1446 1092">• We will confirm with both in-house and external legal counsel the completeness of the contingent liabilities reported by management. <li data-bbox="844 1092 1446 1312">• We will perform a lookback assessment of the reserve balance for claims that have been settled after year-end to validate the valuation of the provision. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|--|
| Investments | |
| <i>(PS 3040 - Portfolio Investments)</i> | |
| <ul style="list-style-type: none">• The City values investments 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 to determine whether the decline in value is other-than-temporary.• We will review the Statement of Compliance report from the investment service provider and consider the impact of any control deficiencies on our audit procedures. |

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 City’s employee future benefits and pension agreements include the Ottawa-Carleton Regional Transit Commission Employees’ Pension Plan, the City of Ottawa Superannuation Fund, WSIB, and other post-employment and post-retirement benefits. • The employee benefit 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 liabilities is determined by reference to the City’s cost of borrowing or plan asset earnings. | <ul style="list-style-type: none"> • We will involve our internal actuaries to perform an assessment of the valuation reports. • For each plan, we will review the 2020 valuation methodology and assumptions used by the actuaries and conclude as to whether the methodology used is in compliance with Canadian public sector accounting standards and we will assess whether the assumptions used are reasonable. • We will review the current pension obligation and pension asset for both pension plans and WSIB and we will review the post-employment obligations and assess whether the appropriate amounts have been recorded in accordance with the relevant standards. |

Our Audit Plan

Areas of audit emphasis

| Area of emphasis | Summary of planned audit procedures |
|--|---|
| <p data-bbox="203 415 803 457">Tangible capital assets</p> <p data-bbox="203 457 803 506"><i>(PS 3150 - Tangible Capital Assets)</i></p> | <ul style="list-style-type: none"> <li data-bbox="836 520 1437 787">• We will walk through the tangible capital asset process to update our understanding of the capitalization process, including the accounting for the Ottawa Light Rail Transit (OLRT) project and other significant agreements. <li data-bbox="836 808 1437 997">• We will perform substantive testing over the additions and disposals of tangible capital assets during the year, as well as transfers of assets under construction to in-service assets. <li data-bbox="836 1018 1437 1438">• We will perform analysis over the additions, transfers, disposals and amortization of tangible capital assets. This will include a review of the timing of when assets were put into or taken out of use, as well as the assumptions used for useful life and depreciation methods. We will take a combined approach, using analytics for insights where appropriate and performing test of details when required. <li data-bbox="836 1459 1437 1795">• 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's representations regarding any commitments entered into during the year.We will conduct substantive testing over a sample of disclosed balances by tracing to the supporting contracts in order to verify the future obligation remaining at year-end. |

Fraud considerations and risk of management override

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 fraud or error.

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.

As a result of our audit planning activities, we have not identified any fraud risks aside from the presumed risk of management override. In response to this risk, we intend to leverage the use of our EY Helix suite of data analytics tools in examining journal entries.

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.

Fair and transparent fees

| | 2020 estimated fees | 2019 actual fees |
|----------------------------|------------------------|---------------------|
| Financial statement audits | 308,480 | \$357,639 |
| Other audit engagements | 35,400 | 74,570 |
| Non-audit engagements | 9,360 | 19,160 |
| Total | <u>\$353,240</u> | <u>\$451,369</u> |

Thought leadership

EY is invested heavily in developing Thought Leadership to support our clients and their governance committees in achieving their goals. Articles developed by EY on topics of relevance to audit committees and boards can be found at the following links:

- https://www.ey.com/en_gl/board-matters
- https://www.ey.com/en_gl/what-we-think
- https://www.ey.com/en_gl/government-public-sector

EY's Thought Leadership practice published an article on the transformation journey many organizations are facing in transitions to a digital environment through COVID-19. This article addresses the focus and goals those charged with governance must have to drive long-term, positive changes.

The complete articles can be found at:

- https://www.ey.com/en_ca/covid-19/what-boards-can-do-to-enhance-oversight-in-times-of-uncertainty

In addition, we have included, in Appendix A, a summary of developments in accounting standards provided by the Public Sector Accounting Board (PSAB).

We sincerely hope that you find the information of use in exercising your oversight role at the City of Ottawa.

Appendix A – Accounting and auditing developments

This summary of decisions of the Public Sector Accounting Board [“PSAB”] has been prepared for information purposes only. Decisions reported are tentative and reflect only the current status of discussions on projects, which might change after further deliberations by PSAB. Decisions to publish exposure draft and Handbook material are final only after a formal ballot process.

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|--|---|---|
| Financial Reporting Developments: | | |
| Financial Instruments (PS 3450), Foreign Currency Translation (PS 2601), Portfolio Investments (PS 3041) and Financial Statement Presentation (PS 1201) | In 2020, in response to COVID-19, the adoption period has been deferred to fiscal periods beginning on or after April 1, 2022. | The new accounting standards need to be implemented in the City of Ottawa financial statements in the fiscal year ending December 31, 2023, or earlier if deemed appropriate. |
| Asset Retirement Obligations | In 2020, in response to COVID-19, the adoption period was deferred to be effective for fiscal years beginning on or after April 1, 2022. Earlier adoption is permitted. | The new accounting standards need to be implemented in the City of Ottawa’s financial statements in the fiscal year ending December 31, 2023, or earlier. |
| Revenue (PS 3400) | In 2020, in response to COVID-19, the adoption period was deferred to be effective for fiscal years beginning on or after April 1, 2023. Earlier adoption is permitted. | The new accounting standards need to be implemented in the City’s financial statements in the fiscal year ending December 31, |

| Accounting and auditing developments | Summary | Effect on the City of Ottawa consolidated financial statements |
|--|--|--|
| | | 2024, or earlier if deemed appropriate. |
| Adoption of International Public Sector Accounting Standards (IPSAS) | At its May 5, 2020 meeting, PSAB voted to adapt IPSAS principles when developing future standards. The implementation date of this decision is April 1, 2021. All standards projects initiated on or after this date, will use the principles of IPSAS in the development of the PSAS standard, if a similar IPSAS already exists. In cases where a similar IPSAS does not exist, PSAS standards would continue to be developed as they are today. | This decision will impact the future development of standards. |

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