AUDIT FINDINGS LETTER

PRIVATE & CONFIDENTIAL
Finance Committee
City of Richmond
6911 No 3. Road
Richmond, BC V6Y 2C1

April 23, 2018

To the Chair and Members of the Finance Committee
of the City of Richmond:

We are pleased to provide the following information for your review and consideration in order to assist you in carrying out your responsibilities with respect to the review and recommendation to Council of the audited consolidated financial statements of the City of Richmond ("the City") for the year ended December 31, 2017. A summary of the information provided is as follows:

Description

- Audit status and opinion
- Significant audit, accounting and reporting matters
- Significant qualitative aspects of accounting practices
- Misstatements
- Control deficiencies
- Documents containing or referring to the audited financial statements
- Independence
- Current developments

This report is intended to communicate to you the results of our examination. We would be pleased to receive any comments or suggestions for improvements which you may have.

We would like to thank the staff of the City for their cooperation and assistance during the course of our audit fieldwork. We appreciate the opportunity to serve you and look forward to a continuing relationship.

This letter is for the use of the Finance Committee for the purposes of carrying out and discharging its responsibilities and should not be used for any other purpose. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this document has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Yours very truly,

C.J. James, CPA, CA
Engagement Partner
604-527-3635

Archie G. Johnston, FCPA, FCA, CIA
Senior Advisor and Quality Reviewer
604-527-3757

Enclosures:
Appendix 1 – Management representation letter

AUDIT STATUS AND OPINION

As of the date of this letter, we have completed the audit of the financial statements, with the exception of certain remaining procedures which include:

- Completion of our discussions with the Finance Committee.
- Completing subsequent event review procedures up to the date of approval of the financial statements, including updating our discussions with management.
- Obtaining signed management representation letter.
- Obtaining evidence that those with approved authority to take responsibility for the City's consolidated financial statements have done so.

We will update the Finance Committee on any significant matters arising from the completion of the above procedures, as additional procedures or adjustments to the financial statements may be necessary.

Our audit report will be dated no earlier than the date on which we have obtained sufficient appropriate audit evidence on which to base our audit opinion on the financial statements, including evidence that:

- all the statements that comprise the financial statements, including the related notes, have been prepared; and
- Council has accepted the consolidated financial statements.

SIGNIFICANT AUDIT, ACCOUNTING AND REPORTING MATTERS

Tangible Capital Assets - Recast of prior year comparative figures

During the City's reconciliation process as part of the year-end financial close, the City identified certain tangible capital assets from prior years that were not recorded on its consolidated financial statements. The City identified a few land and building transactions that should have been previously recorded as tangible capital assets or removed from the City's asset registry. The net impact of these items was an immaterial understatement of $11.77M for the 2016 tangible capital assets, $7.66M for the 2016 annual surplus, and $4.11M for the 2016 opening accumulated surplus. The understatement resulted in an increase of 0.54% in the 2016 tangible capital assets and an increase of 7.3% in the 2016 annual surplus.

Accordingly, management has recorded the impact of these immaterial errors retrospectively and recast the comparative figures on the consolidated financial statements. Note 3 of the consolidated financial statements describe the details of these adjustments. As part of our audit, we reviewed management's analysis, including testing a sample of the revisions, and concur with management's assessment of the adjustments required. We also ensured that note disclosures on the financial statements explaining the impact of these adjustments are appropriate.

Management has further refined their process to ensure that capital transactions are communicated internally on a timely basis and thus appropriately recorded on the consolidated financial statements.

Investment in Government Business Enterprise (“GBE”) – Lulu Island Energy Company Ltd. (“LIEC”)

LIEC is a municipal corporation wholly-owned by the City. In 2016 and prior years, LIEC was considered a government organization and consolidated into the financial statements of the City. In 2017, Management determined that LIEC meets the Public Sector Accounting Standards (“PSAS”) criteria of being classified as a Government Business Enterprise (“GBE”) as set out in PSAS 1300. A key criteria in assessing whether LIEC is a GBE is whether it could, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity, the City of Richmond (“the City”). We reviewed the detailed analysis performed by management to come to the determination of whether LIEC meets the criteria of being a GBE and noted that management’s conclusion was appropriate.

Effective January 1, 2017, LIEC has been classified as a GBE and LIEC’s financial information is now recorded in the City’s financial statements using the modified equity method. The financial statements of LIEC are now prepared in accordance with International Financial Reporting Standards (IFRS,) as required for a GBE. Due to the change in the financial reporting framework of LIEC, an accounting adjustment was required to be recorded within opening accumulated surplus. We reviewed the reconciliation performed by management and ensured that the LIEC financial results are being accounting on a modified equity basis, with the appropriate elimination entries being made upon consolidation. No issues were noted.

Significant Qualitative aspects of accounting practices

The following items being reported relate to the qualitative aspects of accounting practices of the City:

Significant Accounting Policies	• Critical accounting policies and practices adopted by the City are appropriate and properly disclosed in the consolidated financial statements. • There were no significant changes in accounting policies during 2017. • There are no significant accounting policies in controversial or emerging areas. • The transactions were correctly recorded in relation to the period in which they are related to. • There were no significant unusual transactions undertaken during the year.
Significant Accounting Estimates	• Management's identification of accounting estimates and process for making such accounting estimates are appropriate. • There were no indicators of possible management bias noted during our audit. • Disclosure of estimation uncertainty in the consolidated financial statements is appropriate.
Significant Disclosures	• There are no particularly sensitive financial statement disclosures. • The disclosures in the consolidated financial statements are consistent and clear. Any potential effect on the consolidated financial statements of significant risks, exposures and uncertainties have been appropriately disclosed.

MISSTATEMENTS

Audit Misstatements – Identification

Misstatements identified during the audit have been categorized as follows:

- uncorrected audit misstatements, including disclosures; and
- corrected audit misstatements, including disclosures.

Corrected Audit Misstatements

The management representation letter includes adjustments identified as a result of the recast of 2016 comparative figures for tangible capital assets as noted above. Management corrected the misstatements in the financial statements.

Uncorrected Audit Misstatements

There were no uncorrected audit misstatements noted from the audit.

CONTROL DEFICIENCIES

As your auditors, we are required to obtain an understanding of internal control over financial reporting (“ICFR”) relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on internal control. Accordingly, we do not express an opinion on the effectiveness of internal control.

Our understanding of ICFR was for the limited purpose described in the preceding paragraph and was not designed to identify all control deficiencies that might be significant deficiencies and therefore, there can be no assurance that all significant deficiencies and other control deficiencies have been identified. Our awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

Identification

We did not identify any control deficiencies that we consider to be significant deficiencies in ICFR.

DOCUMENTS CONTAINING OR REFERRING TO THE AUDITED FINANCIAL STATEMENTS

We are required by our professional standards to read only documents containing or referring to audited financial statements and our related auditors' report that are available through to the date of our auditors' report. The objective of reading these documents through to the date of our auditors' report is to identify material inconsistencies, if any, between the audited financial statements and the other information. We also have certain responsibilities, if on reading the other information for the purpose of identifying material inconsistencies, we become aware of an apparent material misstatement of fact.

We are also required by our professional standards when the financial statements are translated into another language to consider whether each version, available through to the date of our auditors' report, contains the same information and carries the same meaning.

INDEPENDENCE

We confirm that 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 applicable legislation or regulation from January 1, 2017 up to the date of this letter.

CURRENT DEVELOPMENTS

The following is a summary of the current developments that are relevant to the Commission.

Related Party Disclosures and Inter-Entity Transactions

- Two new Handbook sections were approved in December 2014, effective for fiscal years beginning on or after April 1, 2017.
- Related parties include entities that control or are controlled by a reporting entity, entities that are under common control and entities that have shared control over or that are subject to shared control of a reporting entity.
- Individuals that are members of key management personnel and close members of their family are related parties. Disclosure of key management personnel compensation arrangements, expense allowances and other similar payments routinely paid in exchange for services rendered is not required.
- Determining which related party transactions to disclose is a matter of judgment based on assessment of:
    - the terms and conditions underlying the transactions;
    - the financial significance of the transactions;
    - the relevance of the information; and
    - the need for the information to enable users' understanding of the financial statements and for making comparisons.

- A related party transaction, with the exception of contributed goods and services, should normally be recognized by both a provider organization and a recipient organization on a gross basis.

- Related party transactions, if recognized, should be recorded at the exchange amount. A public sector entity's policy, budget practices or accountability structures may dictate that the exchange amount is the carrying amount, consideration paid or received or fair value.

Revenue

- PSAB is proposing a single framework to categorize revenues to enhance the consistency of revenue recognition and its measurement.
- An Exposure Draft (ED) was issued in May 2017 seeking feedback from stakeholders. Responses are currently under deliberation.
- The ED proposes that in the case of revenues arising from an exchange, a public sector entity must ensure the recognition of revenue aligns with the satisfaction of related performance obligations.
- The ED proposes 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.
- The new section would be applied retroactively with restatement for fiscal years beginning on or after April 1, 2021.

Assets, Contingent Assets and Contractual Rights

- Three new Handbook sections were approved in March 2015, effective for fiscal years beginning on or after April 1, 2017.
- The intended outcome of the three new Handbook Sections is improved consistency and comparability.
- The standard includes enhanced guidance on the definition of assets and disclosure of assets to provide users with better information about the types of resources available to the public sector entity.
- Disclosure of contingent assets and contractual rights is required to provide users with information about the nature, extent and timing of future assets and potential assets and revenues available to the public sector entity when the terms of those contracts are met.

Employee Future Benefit Obligations

- PSAB has initiated a review of sections PS3250 Retirement Benefits and PS3255 Post-Employment Benefits Given the complexity of issues involved and potential implications of any changes that may arise from this review, the project will be undertaken in phases. Phase I will address specific issues related to measurement of employment benefits. Phase II will address accounting for plans with risk sharing features, multi-employer defined benefit plans and sick leave benefits.

- An Invitation to Comment was issued in November 2016 and closed March 2017, seeking guidance on whether the deferral provisions in existing public sector standards remain appropriate and justified and the appropriateness of accounting for various components of changes in the value of the accrued benefit obligation and plan assets. Responses are currently under deliberation.
- A second invitation to Comment was issued in November 2017 that closed in March 2018. The objectives of this invitation is to explain why PSAB is considering whether the current discount rate guidance in Section PS 3250 is sufficient, to identify potential alternatives and related considerations, and to seek stakeholder input prior to PSAB establishing its preliminary views on the issue.
- A third invitation to Comment is being developed on other aspects of the project.
- The ultimate objective of this project is to issue a new employment benefits section to replace existing guidance.

<u>Public Private Partnership</u>

- A taskforce was established in 2016 as a result of increasing use of public private partnerships for the delivery of services and provision of assets.
- A Statement of Principles (SOP) was issued in August 2017 which proposes new requirements for recognizing, measuring and classifying infrastructure procured through a public private partnership. Responses are currently under deliberation.
- The SOP proposes 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 SOP proposes the public sector entity recognize 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, with a liability of the same amount if one exists. Cost would be measured by discounting the expected cash flows by a discount rate that reflects the time value of money and risks specific to the project.

Asset Retirement Obligations

- A new standard is under development addressing the recognition, measurement, presentation and disclosure of legal obligations associated with retirement of tangible capital assets in productive use. Retirement costs would be recognized as an integral cost of owning and operating tangible capital assets. PSAB currently contains no specific guidance in this area.
- PSAB recently released an Exposure Draft following the consideration of comments received in response to the previously released Statement of Principles. Responses are currently under deliberation.
- The proposed ARO standard would 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 would be added to the historical cost of the asset and amortized over its useful life.
- As a result of the proposed standard, the public sector entity would 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.
- The Exposure Draft has a proposed effective date of April 1, 2021 for the standard.

Financial Instruments and Foreign Currency Translation

- PSAB approved new standards for financial instruments in March 2011 effective for years commencing on or after April 1, 2012. . In the case of the Corporation, the new requirements are effective for fiscal years beginning on or after April 1, 2019. For entities with a December year end, this means that 2020 is the first year that the standard must be followed

- Equity instruments quoted in an active market and free-standing derivatives are to be carried at fair value. All other financial instruments, including bonds, are to be carried at cost or amortized cost. Entities will have an option to record any financial instrument, including bonds, at fair value, however, this election must be made on initial recognition of the financial instrument and is irrevocable.

- Hedge accounting is not permitted.

- A new statement, the Statement of Re-measurement 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.

APPENDIX 1: MANAGEMENT REPRESENTATION LETTER

KPMG LLP
Metrotower I
Suite 2400 – 4710 Kingsway
Burnaby, BC V5H 4M2

Date of Council's acceptance of the financial statements

Ladies and Gentlemen:

We are writing at your request to confirm our understanding that your audit was for the purpose of expressing an opinion on the consolidated financial statements (hereinafter referred to as "financial statements") of the City of Richmond ("the City") as at and for the period ended December 31, 2017.

General:

We confirm that the representations we make in this letter are in accordance with the definitions as set out in **Attachment I** to this letter.

We also confirm that, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Responsibilities:

1) We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated October 13, 2017, for:

   a) the preparation and fair presentation of the financial statements and believe that these financial statements have been prepared and present fairly in accordance with the relevant financial reporting framework

   b) providing you with all relevant information, such as all financial records and related data, including the names of all related parties and information regarding all relationships and transactions with related parties, and complete minutes of meetings, or summaries of actions of recent meetings for which minutes have not yet been prepared, of Council and Committees of Council that may affect the financial statements, and access to such relevant information

   c) such internal control as management determined is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. We also acknowledge and understand that we are responsible for the design, implementation and maintenance of internal control to prevent and detect fraud.

   d) ensuring that all transactions have been recorded in the accounting records and are reflected in the financial statements.

   f) providing you with written representations that you are required to obtain under your professional standards and written representations that you determined are necessary.

   g) ensuring that internal auditors providing direct assistance to you, if any, were instructed to follow your instructions and that management, and others within the entity, did not intervene in the work the internal auditors performed for you.

Internal control over financial reporting:

2) We have communicated to you all deficiencies in the design and implementation or maintenance of internal control over financial reporting of which management is aware.

Fraud & non-compliance with laws and regulations:

3) We have disclosed to you:

   a) the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud

   b) all information in relation to fraud or suspected fraud that we are aware of and that affects the City and involves: management, employees who have significant roles in internal control, or others, where the fraud could have a material effect on the financial statements

   c) all information in relation to allegations of fraud, or suspected fraud, affecting the City's financial statements, communicated by employees, former employees, analysts, regulators, or others

   d) all known instances of non-compliance or suspected non-compliance with laws and regulations, including all aspects of contractual agreements, whose effects should be considered when preparing financial statements

   e) all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements

Commitments & Contingencies:

4) There are no:

   a) Other liabilities that are required to be recognized and no other contingent assets or contingent liabilities that are required to be disclosed in the financial statements in accordance with the relevant financial reporting framework, including liabilities or contingent liabilities arising from illegal acts or possible illegal acts, or possible violations of human rights legislation.

Subsequent events:

5) All events subsequent to the date of the financial statements and for which the relevant financial reporting framework requires adjustment or disclosure in the financial statements have been adjusted or disclosed.

Related parties:

6) We have disclosed to you the identity of the City's related parties.

7) We have disclosed to you all the related party relationships and transactions/balances of which we are aware.

8) All related party relationships and transactions/balances have been appropriately accounted for and disclosed in accordance with the relevant financial reporting framework.

Estimates:

9) Measurement methods and significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

Non-SEC registrants or non-reporting issuers:

10) We confirm that the City is not a Canadian reporting issuer (as defined under any applicable Canadian securities act) and is not a United States Securities and Exchange Commission ("SEC") Issuer (as defined by the Sarbanes-Oxley Act of 2002). We also confirm that the financial statements of the City will not be included in the consolidated financial statements of a Canadian reporting issuer audited by KPMG or an SEC Issuer audited by any member of the KPMG organization.

11) We have recognized authority to take, and have taken, responsibility for the financial statements.

Assets & Liabilities - General:

12) The City has satisfactory title to all owned assets.

13) We have no knowledge of any liens or encumbrances on assets and /or assets that have been pledged or assigned as security for liabilities, performances of contracts, etc., not disclosed in the financial statements.

14) We have no knowledge of any plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

Receivables:

15) Receivables reported in the financial statements represent valid claims against taxpayers and other debtors for taxes, fees or other charges arising on or before the balance sheet date. Receivables have been appropriately recorded at their net realizable value.

Contractual Agreements:

16) The City has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of non-compliance.

Environmental Matters:

17) The City has appropriately recognized, measured and disclosed environmental matters in the financial statements.

Employee Future Benefits:

18) The employee future benefit costs, assets and obligation, if any, have been determined, accounted for and disclosed in accordance with the financial reporting framework.

19) We have no knowledge of arrangement (contractual or otherwise) by which programs have been established to provide post-employment benefits, except as disclosed to you.

20) The significant accounting policies the City has adopted in applying PS 3255, Post-employment benefits, compensated absences and termination benefits (hereinafter referred to as "PS 3255") are disclosed in notes to the financial statements.

21) All arrangements (contractual or otherwise) by which programs have been established to provide post-employment benefits have been disclosed to you and included in the determination of pension and post-employment costs and obligations. This includes:

a) pension and other retirement benefits expected to be provided after retirement to employees and their beneficiaries.

b) post-employment benefits expected to be provided after employment but before retirement to employees and their beneficiaries. These benefits include unused sick leave and severance benefits.

c) compensated absences for which it is expected employees will be paid. These benefits include accumulating sick days; and

d) termination benefits.

22) The post-employment benefit costs, assets and obligations have been determined, accounted for and disclosed in accordance with PS 3255. In particular:

a) each of the best estimate assumptions used reflects management's judgment of the most likely set of conditions affecting future events; and

b) the best estimate assumptions used are, as a whole, consistent within themselves, and with the valuation method adopted for purposes of this evaluation.

23) The assumptions included in the actuarial valuation are those that management instructed Mercer Human Resource Consulting ("Mercer") to use in computing amounts to be used by us in determining pension costs and obligations and in making required disclosures in the above-named financial statements, in accordance with PS 3255.

24) In arriving at these assumptions, management has obtained the advice of Mercer, but has retained the final responsibility for them.

25) The source data and plan provisions provided to the actuary for preparation of the actuarial valuation are accurate and complete.

26) All changes to plan provisions or events occurring subsequent to the date of the actuarial valuation and up to the date of this letter have been considered in the determination of pension and other post-employment benefit costs.

27) We agree with Mercer's findings in evaluating the accuracy and completeness of employee future benefits and have adequately considered their qualifications in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give nor cause any instructions to be given to Mercer with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on Mercer's independence and objectivity.

Other information:

28) We confirm that the final version of the annual report will be provided to you when available and prior to issuance by the City, to enable you to complete your audit procedures in accordance with professional standards.

Other:

29) Expenditures have been appropriately authorized and actual expenditures have not exceeded budgeted expenditures detailed in the budget bylaw.

30) We have appropriately prepared the Form C2 – Home Owner Grant: Treasurer/Auditor Certification in accordance with the financial reporting provisions of Section 12(1) of the Home Owner Grant Act.

31) We have complied with subsection 2 and 3, in section 124 of Part 8 of the School Act.

32) All transfers out of statutory reserves have been approved by bylaw except for those transfers allowed by Council resolution.

Misstatements:

33) We approve the corrected misstatements identified by you during the audit described in Attachment II.

Comparative Information:

34) In respect of the recast made to correct immaterial misstatements in the comparative information for tangible capital asset adjustments, we affirm that the written representations we previously provided to you, for the prior period financial statements, remain appropriate.

Yours very truly,

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Andrew Nazareth, General Manager, Finance & Corporate Services

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Jerry Chong, Director of Finance

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Cindy Gilfillan, Manager, Financial Reporting

cc: Finance Committee

Attachment I – Definitions

Materiality

Certain representations in this letter are described as being limited to matters that are material. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.

Fraud & error

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of any of City's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Related parties

In accordance with Canadian public sector accounting standards, a *related party* exists when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two or more parties are related when they are subject to common control, joint control or common significant influence. Related parties also include management and immediate family members.

In accordance with Canadian public sector accounting standards, a related party transaction is defined as a transfer of economic resources or obligations between related parties, or the provision of services by one party to a related party, regardless of whether any consideration is exchanged. The parties to the transaction are related prior to the transaction. When the relationship arises as a result of the transaction, the transaction is not one between related parties.

Attachment II – Summary of Audit Misstatements Schedules

Summary of Corrected audit misstatements

#	Description	Assets Increase/ (Decrease)	Liabilities (Increase)/ Decrease	Annual Surplus (Increase)/ Decrease	Opening Accumulated Surplus at period end (Increase)/ Decrease
1	Dr. Tangible capital assets – 2016 (recast) Cr. Annual surplus – 2016 (recast) Cr. Opening accumulated surplus – 2016 (recast) *To adjust for previously unrecorded tangible capital assets obtained in prior years and the corresponding impact on the 2016 annual surplus and accumulated surplus.*	11,767,000 - -	- - -	- - -	- (7,655,000) (4,112,000)
	Total	11,767,000	-	-	(11,767,000)

Summary of Uncorrected audit misstatements

There were no uncorrected audit misstatements for the year ended December 31, 2017.