

City of Ottawa

2009 financial statement audit plan





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Members of the Audit, Budget and Finance Committee
Corporation of the City of Ottawa

October 9, 2009

Dear Members of the Committee,

On October 20th, 2009, we are meeting with you to discuss our audit approach and current year audit plan for the City of Ottawa. We will outline the scope of our services, identify the Ernst & Young team that will serve you and present some key considerations that will affect the 2009 audit. We are providing the enclosed materials so you can familiarize yourselves with them prior to our meeting.

Our audit is designed to express an opinion on the 2009 consolidated financial statements as of December 31st, 2009. We are currently completing the planning phase of our audit. We will consider the City of Ottawa's current and emerging business risks, assess those that could materially affect the financial statements and align our procedures accordingly. The plan will be responsive to your needs and will maximize audit effectiveness so we can deliver the high quality audit you expect.

The City of Ottawa selected Ernst & Young to perform its 2009 audit and we appreciate your confidence. Our commitment to quality will be reflected in every aspect of our work.

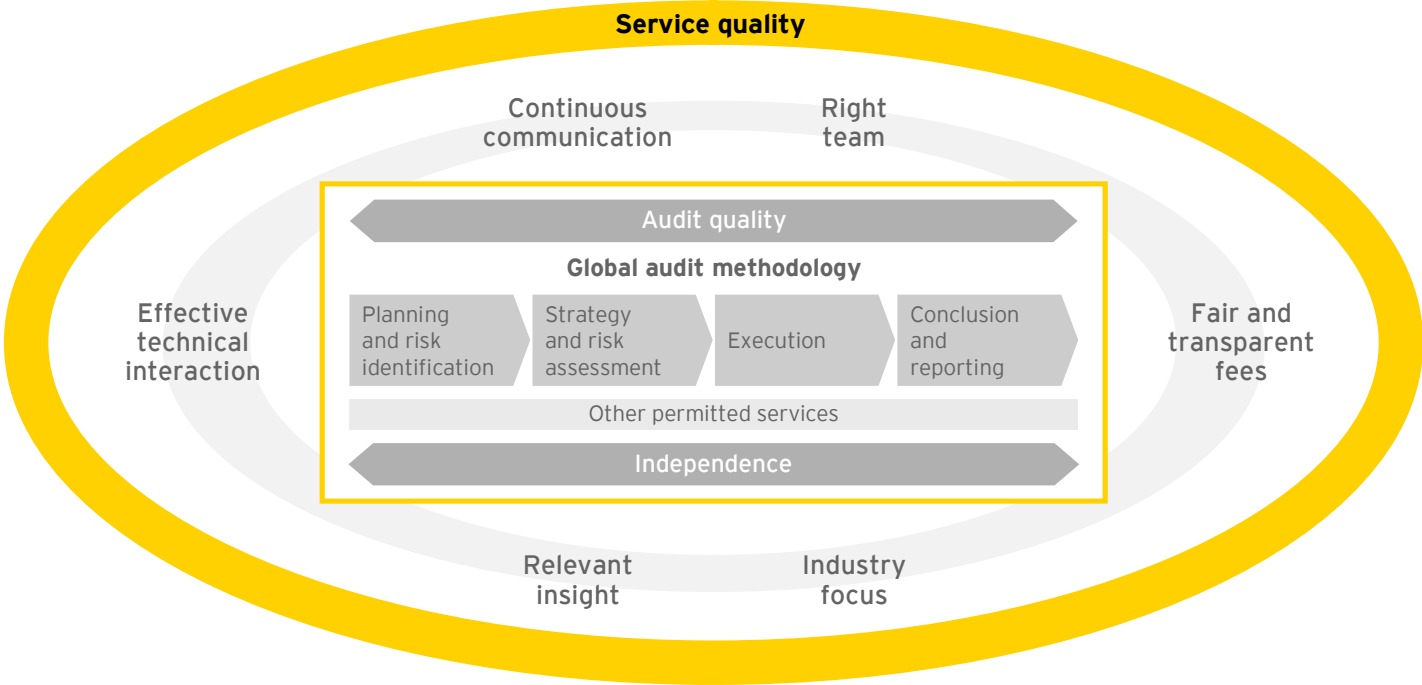
Very truly yours,

Deanna Monaghan

Agenda

- ▶ Our client service commitment to the City of Ottawa
- ▶ Deliverables
- ▶ Global audit methodology
 - Materiality
 - Internal control strategy
 - Audit approach
 - Accounting and auditing developments
 - Critical policies, estimates and areas of emphasis
 - Fraud considerations and the risk of management override
- ▶ Client service team
- ▶ Fair and transparent fees
- ▶ Appendix A — Timing of required communications

Our client service commitment to the City of Ottawa



Not adversarial



Maintaining our objectivity



Not cozy

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 Company’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.

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 financial statements of City of Ottawa related entities in accordance with municipal requirements ▶ Express opinions on the annual financial statements of the OC Transpo Benefit Trust, OC Transpo Benefit Plan and the Pine View Municipal Golf Course ▶ 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
Internal control communications	<ul style="list-style-type: none"> ▶ Issue a written communication to management and the Audit, Budget and Finance Committee describing significant weaknesses in internal control identified during our audit ▶ 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
Other services	<ul style="list-style-type: none"> ▶ Issue a written communication to the committee about independence matters in accordance with CICA Handbook Section 5751, <i>Communications with those Having Oversight Responsibility for the Financial Reporting Process</i> ▶ Perform translation for the French consolidated financial statements and financial highlights included in the annual report of the City of Ottawa

Global audit methodology

Overview of the audit process

Ernst & Young audit process



Important planning matters for audit committee consideration

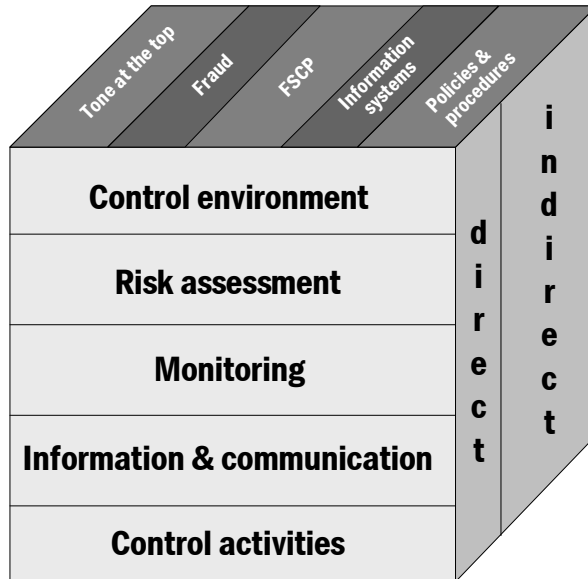
- ▶ Materiality
- ▶ Internal control strategy
- ▶ Audit approach
- ▶ Accounting and auditing developments
- ▶ Critical policies, estimates and areas of emphasis
- ▶ Fraud considerations and the risk of management override

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 2009 operating budget, we estimate the materiality for the audit of the 2009 financial statements to be \$24M (\$23M in 2008]), which represents 1% of budgeted operating expenditures at December 31, 2009. The 2009 preliminary materiality level will be reviewed on an ongoing basis throughout our 2009 audit. Should actual results vary significantly from those forecast, 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 company'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

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

- ▶ Audit, Budget and Finance 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

Example 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
	IT-dependent manual (Both manual and automated aspects)		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).
	Application (Edit and validation checks, calculations, interfaces, authorizations)		Application controls are tested directly. Opportunity exists to alter the extent of testing if ITGCs are tested and determined to be effective.
	Manage change (Only appropriately authorized, tested, and approved changes are made to applications, interfaces, databases, and operating systems)	Logical access (Only authorized persons have access to data and applications and that they can perform only specifically authorized functions)	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. We expect ITGCs will be assessed as effective
	Other ITGCs (Proper data backup and recovery, programs executed as planned, deviations from scheduled processing are identified and resolved in a timely manner)		

Audit approach

Area	Comments
<p>Our planned audit approach</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 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 Company were determined to be significant based on preliminary materiality determinations except the following:</p> <ul style="list-style-type: none"> ▶ Prepaid expenses <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"> ▶ Cash and short term investments ▶ Accounts receivable ▶ Investments ▶ Inventories ▶ Accounts payable ▶ Revenues ▶ Expenses (including Payroll expenses) <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>

Accounting and auditing developments

Canadian developments

Accounting and auditing developments	Summary	Effect on the City
PS 3150 Tangible Capital Assets	<ul style="list-style-type: none"> ▶ In 2006, PS 3150 adopted a new requirement for Tangible Capital Asset Reporting (described in the CICA PSAB Handbook), which impacts the financial statements of the City of Ottawa starting in fiscal year 2009. PS 3150 requires that the City report its tangible capital assets, additions to the capital assets, amortization of the assets and deletions or removal of the assets as appropriate. ▶ This section is effective for the consolidated financial statements ending December 31, 2009. 	<ul style="list-style-type: none"> ▶ The City has developed a methodology and process for recording the assets in accordance with PS 3150. ▶ We have reviewed the procedures, and are in the process of auditing the assets recorded by the City.
PS 1200 Financial Statement Presentation	<ul style="list-style-type: none"> ▶ In 2006, PS 1200 was modified to include the adoption of the full accrual basis of accounting for local governments. The new standards are effective for fiscal years beginning on or after January 1, 2009. 	<ul style="list-style-type: none"> ▶ The City is in the process of assessing the impact and implementing the changes required by PS 1200 ▶ We will review the procedures performed as a part of our year end audit.

Accounting and auditing developments

Accounting and auditing developments	Summary	Effect on the City
Impact of International Financial Reporting Standards (IFRS)	<ul style="list-style-type: none"> ▶ On February 13, 2008 the Canadian Accounting Standards Board (“AcSB”) confirmed 2011 as the official changeover date for publicly listed Canadian companies to start using International Financial Reporting Standards (IFRS). The transition will affect interim and annual financial statements relating to years beginning on or after January 1, 2011. ▶ The AcSB has issued a new Exposure Draft in March 2009 to confirm its intentions to that governments and other entities in the public sector will continue to refer to the CICA Public Sector Accounting handbook. ▶ PSAB issued an Exposure Draft in July 2009 which confirms that local governments will continue to refer to the CICA Public Sector Accounting handbook. 	<ul style="list-style-type: none"> ▶ The City of Ottawa does not currently meet the AcSB’s definition of a publicly accountable enterprise. As such, no formal implementation steps will be undertaken by the Corporation of the City of Ottawa until a PSAB handbook section is finalized.
Financial reporting by not-for-profit organizations - invitation to comment	<ul style="list-style-type: none"> ▶ The Accounting Standards Board and Public Sector Accounting Board (PSAB) have jointly issued an Invitation to Comment to invite feedback on the future of financial reporting by not-for-profit organizations. ▶ In the case of public sector not-for-profit organizations (those organizations consolidated into government accounts), the Public Sector Accounting Board has tentatively concluded that public sector standards alone, or public sector standards supplemented by the 4400 series of sections in the CICA Handbook – Accounting (4400 series), are the alternatives. ▶ An option of supplementing IFRS with the 4400 series was determined not to be an available option. 	<ul style="list-style-type: none"> ▶ Comments were due on June 30, 2009.

Critical policies, estimates and areas of emphasis

Executive summary

Area	Critical accounting policy	Ernst & Young comments
Revenues		
Net taxes available for municipal purposes, fees and user charges and government grants	✓	▶ We will conduct substantive procedures on the tax revenues including a verification of the municipal tax rates as approved by City Council
Assets		
Cash and Short Term Investments	✓	▶ Year end balances will be confirmed and we will substantively test balances to verify that their actual value is not lower than their carrying value
Investments	✓	▶ Fair value measurements will be confirmed with the custodian of the investments, and will be assessed for other-than-temporary impairment
Accrued Liabilities		
Deferred Revenue	✓	▶ We will verify funding agreement for amounts received to ensure that restricted amounts are recorded as deferred revenues
Employee Benefit Costs (Pension accounting)	✓	▶ We will review the 2009 valuation methods and assumptions used by the actuaries. We will conclude as to whether the method used was 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
Property Tax Accruals	✓	▶ Management's property tax appeals analysis will be reviewed to estimate the likely property tax appeal liability at year end.
Capital Lease Obligations	✓	▶ We will read any new lease and/or public private partnership agreements and determine the appropriateness of the accounting for these transactions.
Other		
Consolidation	✓	▶ The consolidation will be reviewed to ensure that all necessary subsidiaries are included in the consolidated financial statements and that interfund transactions are eliminated

Critical policies, estimates and areas of emphasis

Area	PSAB basis	Ernst & Young comments
<p>Revenue recognition</p> <p>Taxation revenues are recorded at the time tax billings are issued.</p>	<p>PS 1200, <i>Financial Statement Presentation</i></p>	<p>The City's method for recognizing revenue is consistent with the prior year policy and industry practice.</p>
<p>▲ Audit response and specific procedures</p>		
<p>Contingent Liabilities</p> <p>Accruals are recorded for regulatory and legal proceedings that arise in the ordinary course of business when probable 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>	<p>PS 3300, <i>Contingent Liabilities</i></p>	<p>We will perform a review of the contingent liabilities and assess managements and legal counsels assumptions for each contingent liability identified.</p> <p>We will confirm with both in house and external legal counsel the completeness of the contingent liabilities reported by management.</p>
<p>▲ Audit response and specific procedures</p>		

Critical policies, estimates and areas of emphasis

Area	GAAP basis	Ernst & Young comments
<p>Investments and financial instruments</p> <p>The City 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>	<p>PS 3040, <i>Portfolio Investments</i></p>	<p>The recent events in the credit market have made valuing a number of investments a subjective and complex process.</p> <p>Further, declines in the fair values of a number of investments will create a higher likelihood that other-than-temporary impairment may exist.</p> <p>The accounting policy is in accordance with PSAB requirements.</p>
<p>▲ Audit response and specific procedures</p>		
<p>Pension accounting</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 Company's management. The assumptions are based on the Company's own experience and forecasts for various attributes. The highly sensitive discount rate for the pension liability is determined by reference to market rates for bond portfolios in which maturities approximate estimated future benefit payments. The City increased its discount rate to 5.25% at 31 December 2008 compared to 4.75% at 31 December 2007.</p>	<p>PS 3050, <i>Retirement Benefits</i></p>	<p>The assumptions (specifically the discount rate assumption) are highly sensitive, thus our procedures include a review of the assumptions used by the specialist.</p>
<p>▲ Audit response and specific procedures</p>		

Critical policies, estimates and areas of emphasis

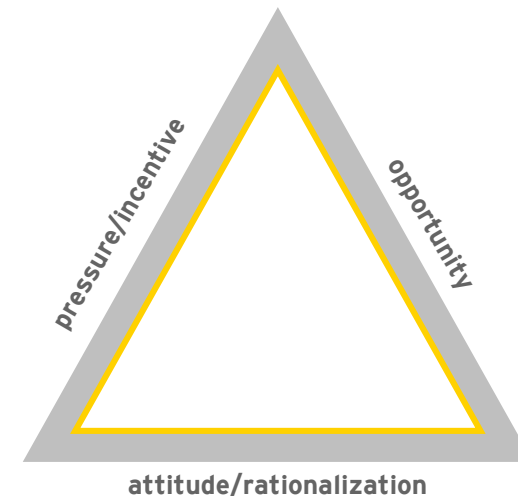
Area	GAAP basis	Ernst & Young comments
<p>Tangible Capital Asset Reporting</p> <p>The City is recording its tangible capital assets at their cost plus all ancillary charges necessary to place the asset in the intended location and condition for use. Since many of the assets have been placed in use prior to the amalgamation of the City of Ottawa, historical costs are not readily available.</p> <p>In these cases, the City is recording the assets by using either a replacement, reproduction or appraisal valuation method.</p> <p>The City has implemented RIVA, an IT system used to manage the conversion of asset data from source databases maintained by asset managers to SAP, the City's accounting system.</p> <p>The RIVA system will also be used by the City to regularly update SAP based on changes in the source databases.</p>	<p>PS 3150, <i>Tangible Capital Assets</i></p>	<p>A substantive audit of the opening balances is underway which reviews the valuation methods and the existence of the assets recorded under PS 3150. This substantive audit also includes a review of the assumptions used for useful life, depreciation methods and the completeness of the opening account balance.</p> <p>In order to assess the reliability of the RIVA system, we will perform an ITGC audit of the system.</p> <p>In order to assess the reliability of the conversion of data from RIVA to SAP, we will perform an audit of the IT conversion.</p>
<p>▲ Audit response and specific procedures</p>		

Fraud considerations and the 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 error or by fraud (CICA Handbook Section 5135, *The Auditor's Responsibility to Consider Fraud*).

Our audit procedures will encompass the requirements of CICA 5135: brainstorming, gathering information to facilitate the identification of and response to fraud risks and performing mandatory procedures 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 fraud, including the risk of management override, using the fraud triangle 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

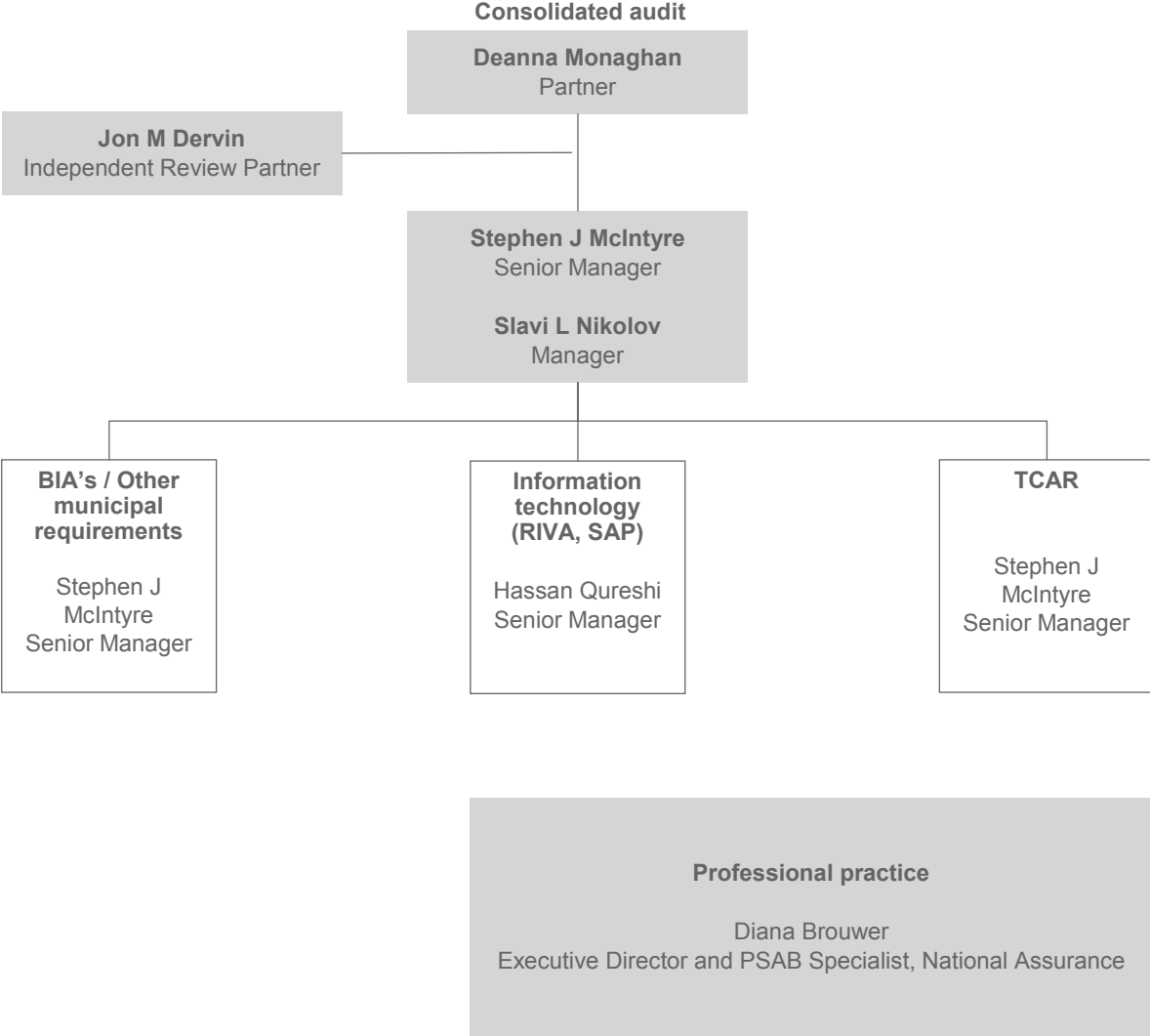
Assurance calendar

	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Client events												
TCA – Part 1												
▶ TCA testing – part 1	■	■										
▶ TCA IT conversion scope	■	■										
▶ Interim planning	■	■										
Audit Plan												
▶ Develop audit plan	■	■										
▶ Present audit plan			■									
TCA – Part 2												
▶ TCA testing – part 2			■									
▶ TCA conversion to SAP			■									
Interim Audit – Part 1												
▶ TCA testing – part 3					■							
▶ TCA fiscal 2009					■							
▶ 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

- ▶ Experience serving public sector and not-for-profit organizations
- ▶ Extensive knowledge of PSAB



Fair and transparent fees

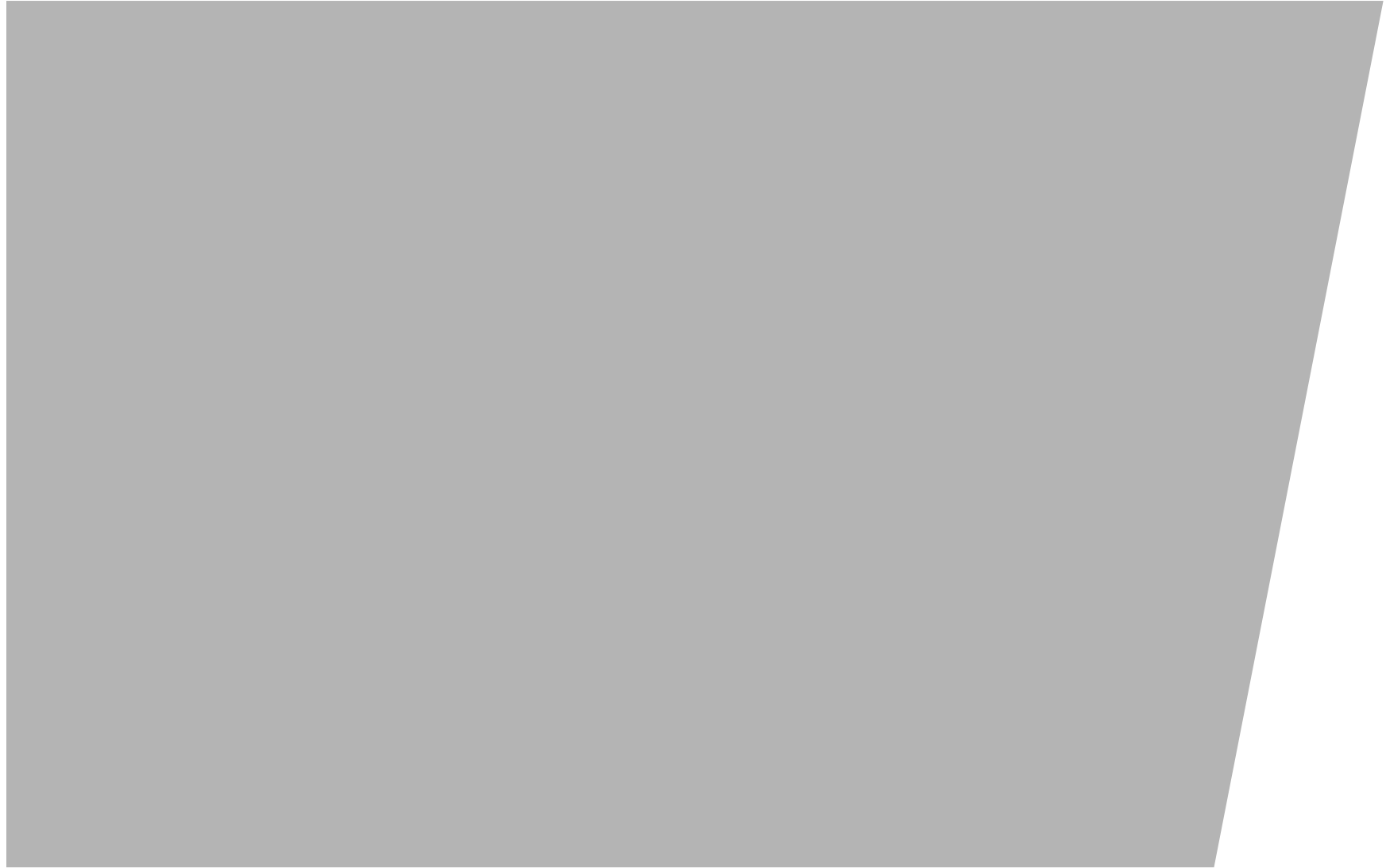
2009 audit fee summary

	2009 budgeted fees \$	2008 actual fees \$	Explanatory notes
Audit of financial statements (1)			
Total audit-related fees	347,900	332,900	
Tangible Capital Asset Reporting (TCAR) and PS 1200 (1)			
Substantive testing of Opening Balances			
RIVA – ITGC reliance audit			
TCA – IT conversion audit			
Total TCAR and PS 1200 related fees	100,000 to 145,000	N/A	
Total fees	447,900 to 492,900	332,900	

(1) Includes fees and expenses related to the fiscal year audit notwithstanding when the fees and expenses were billed or when the services were rendered.

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		
Our responsibility under GAAS, including other information in documents containing audited financial statements		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	
Non-trivial recorded audit adjustments		X
Unrecorded audit differences considered by management to be immaterial		X
Our judgments about the quality of the Company'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	
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

Timing of required communications

	Communicate when event occurs	Communicate on a timely basis, at least annually
Communications required on all audits (cont'd)		
Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements	X	
Significant weaknesses identified during our audit		X
Related party transactions identified that are not in the normal course of operations		X
Matters relating to component entities of the Company		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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About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 130,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve potential.

About Ernst & Young's Assurance Services

Strong independent assurance provides a timely and constructive challenge to management, a robust and clear perspective to audit committees and critical information for investors and other stakeholders. The quality of our audit starts with our 60,000 assurance professionals, who have the experience of auditing many of the world's leading companies. We provide a consistent worldwide audit by assembling the right multidisciplinary team to address the most complex issues, using a proven global methodology and deploying the latest, high-quality auditing tools. And we work to give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our work worldwide. It's how Ernst & Young makes a difference.

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