

ASSURANCE AND ADVISORY
BUSINESS SERVICES

JUNE 17, 2008



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City of Ottawa

Audit Results and Communications

Report to the Corporate Services and Economic Development Committee



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June 17, 2008

Corporate Services and Economic Development Committee
City of Ottawa

Dear Committee Members:

We are pleased to present the results of our audit of the consolidated financial statements of the City of Ottawa ('the City'). The audit is designed to express an opinion on the 2007 consolidated financial statements. We continue to receive the full support and assistance of the City's personnel in conducting our audit.

This report is intended solely for the information and use of the Committee, City Council and management, and is not intended to be and should not be used by anyone other than these specified parties. We disclaim any responsibility to any third party who may rely on it. Further, this report is a by-product of our audit of the 2007 financial statements and indicates matters identified during the course of our audit. Our audit did not necessarily identify all matters that may be of interest to the Committee in fulfilling its responsibilities.

We appreciate this opportunity to meet with you to discuss the contents of this report and answer any questions you may have about these or any other audit-related matters.

Very truly yours,

A handwritten signature in black ink that reads "Ernst & Young LLP".

Chartered Accountants
Licensed Public Accountants

CITY OF OTTAWA
AUDIT RESULTS AND COMMUNICATIONS
DECEMBER 31, 2007

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2007 Audit Results and Communications

SUMMARY OF WHAT WE AGREED TO DO

As discussed with the Committee during our planning process, our audit plan represented an approach responsive to our understanding of the City and its environment, including its internal control and, our assessment of risks of material misstatement of the 2007 consolidated financial statements. Specifically, we designed our audit to:

- Express an opinion on the consolidated financial statements of the City.
- 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.

AUDIT SCOPE AND COVERAGE

AUDIT OF FINANCIAL STATEMENTS

We previously communicated to you during audit planning an overview of our audit scope and approach relating to the audit of the financial statements.

Our audit scope was developed after considering inherent and control risks and the existence of effective internal controls. A variety of factors were considered when establishing individual audit scopes for the City's locations, including size, specific risks, the volume and types of transactions processed, changes in the business environment, internal audit activity, corporate monitoring controls in place, as well as other factors. We also considered the overall degree of commonality in processes at the City's locations and the degree of centralization of operations.

Our procedures for your organization were primarily of a substantive nature. Our principal areas of focus were:

- Revenue – net taxes available for municipal purposes, fees, user charges and government grants
- Assets – cash and short-term investments
- Accrued liabilities – employee benefit costs, property tax accruals, capital lease obligations
- Other – pension assets and obligations related to the OC Transpo benefit plan and the City of Ottawa Superannuation Fund.

We have provided details of key findings and observations identified during our audit below.

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FINDINGS AND OBSERVATIONS—FINANCIAL STATEMENT ACCOUNTS AND DISCLOSURES

Key issues identified and addressed as part of our audit included the following.

Key Issue	Summary of Procedures and Findings
Significant Accounting Estimates - Employee Benefit Costs	<p>An actuarial valuation of the City of Ottawa's non-pension post retirement and post employment obligations was performed by the City's external actuaries as at September 30, 2007 (the date of the data) and extrapolated to December 31, 2007 for the purposes of the year end financial statements.</p> <p>We reviewed the valuation methods and assumptions used by the Actuaries (Mercer Consultants) to prepare the valuation and concluded that the method used was in compliance with Canadian Generally Accepted Accounting Principles as per PS 3250 and that the assumptions used were reasonable.</p> <p>During the current year, there was an amendment to the plan resulting in a cost to the plan of approx. \$27M. The amendment was the result of arbitrated changes reinstating certain previously removed retiree benefit cost sharing clauses of the plan. The cost of the amendment was properly accounted for as an expenditure in the year the amendment occurred.</p> <p>We noted during our procedures that the City amortizes actuarial gains and losses to income in the year the gain or loss occurs. This is inconsistent with the requirements of PS 3250 which requires that actuarial gains and losses be amortized over the expected average remaining service life of employees and that any unamortized balance be used to offset the impact of a plan amendment in the year an amendment takes place. We reviewed the impact of this accounting difference looking back to initial implementation of PS 3250 in 2001 and, as a result, a difference of approximately \$23M has been recorded on our Summary of Audit Differences. Note that \$17.1M of this error relates to an overstatement of income in the prior year and as such, this amount is included in the turnaround differences on our Summary of Audit Differences. The remaining \$6.165M is included as a current year difference.</p> <p>The management of the City has agreed to amortize any new actuarial gains and losses in accordance with PS 3250 going forward.</p>
Landfill closure and post-closure liabilities	<p>The City's landfill closure and post-closure liability is based on actuarial valuations performed by two independent firms whose reports are dated January and February 2006. As per PS 3270, at least every three years, an assessment of the need for a comprehensive review of capacity should be completed. The City should engage in such a comprehensive review for the year ended December 31, 2008.</p>
Significant Accounting Estimates - Property Tax Appeals	<p>Management reviewed the historical data regarding property tax appeals to estimate the likely property tax appeal liability that existed at year end. Based on the analysis, a liability of \$3.6 million was estimated to exist at December 21, 2007 which is not recorded in the consolidated statement of financial position. As a result this amount has been recorded on our Summary of Audit Differences.</p>

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Key Issue	Summary of Procedures and Findings
Significant Accounting Estimates - Contingent Liabilities	<p>During fiscal 2005 The City of Ottawa was required to adopt accounting policy Contingent liabilities, Section PS 3300. This Section establishes recognition and disclosure standards dealing with contingent liabilities in government summary financial statements.</p> <p>The Section requires:</p> <ul style="list-style-type: none"> • a government to accrue a contingent liability when the expected future confirming event is likely to occur; that an accrued contingent liability be derecognized when it is settled or otherwise extinguished or when the future confirming event is unlikely. • a government to disclose a contingent liability unless the occurrence of the future confirming event is unlikely. <p>In the course of its business, the City becomes involved in various claims and legal proceedings. Litigation is subject to many uncertainties and the outcome of individual matters is not predictable. A provision for these claims has been recorded in the financial statements based on management's best estimate of the likely outcome. Should claims be settled for amounts over and above established accruals, which could be material to the financial results in the year of settlement, the excess expense will be charged to operations as incurred.</p> <p>During the audit, we identified approximately \$2 million overstatement of claims accrued in the financial statements. This amount was subsequently adjusted by the City in the financial statements.</p> <p>On June 6, 2007, Siemens Canada filed a statement of claim against the City for \$177 million alleging breach of contract and other duties and on September 14, 2007, St. Lawrence Cement Inc. filed a statement of claim against the City for \$40.5 million alleging breach of obligations. Both claims are in relation to the termination of the Light Rail Contract. No amount has been accrued in the consolidated financial statements as it is not possible to reasonably estimate the resolution of the matter. However, these claims have been disclosed in Note 13(b) to the financial statements.</p>
Nortel Subleases	<p>In 2003 the City took over Nortel's capital lease relating to the 100 Constellation locations. The City was paid a rent incentive of \$25 million which consisted of \$16.3 million (difference between original lease rate and current market lease rate) and \$9.1 million (present value of City's subleases on 3 properties with lease term until 2007). In prior years, the City over amortized the recognition of deferred revenue on the subleased properties resulting in a current year understatement of deferred revenue of \$5.1 million. The impact on current year expenditures was an overstatement of \$239 thousand. This amount has been recorded on the Summary of Audit Differences.</p>
Ottawa Paramedic Services headquarters - capital lease obligation	<p>During our audit, we noted an error in the present value calculation related to the Ottawa Paramedic Headquarters capital lease obligation. The resulting difference is an understatement of the capital lease obligations by approx. \$7.8M. The amount has been carried to our Summary of Audit Differences.</p>
Expenditures recorded in the wrong period	<p>During the course of our audit, we noted four instances in which expenditures were recorded in the wrong period. These resulted in an overstatement of transit capital expenditures of approx. \$2.8M, an overstatement of drug benefit expenditures of approx. \$2M, an understatement of social services expenditures of approx. \$800K and an understatement of WSIB liability of approx. \$239K. In addition, although the actual WSIB liability impact for this year was only \$239K, the impact on the opening amounts to be recovered would be approx. \$3.1M. These amounts have been recorded on our Summary of Audit Differences.</p>

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REQUIRED COMMUNICATIONS

CICA Handbook Section 5751 and other professional standards require the auditor to communicate certain matters to the Committee that may assist the Committee in overseeing management's financial reporting and disclosure process. Below we summarize these required communications as they apply to the City.

Area	Comments
<p>Auditors' Responsibilities under Generally Accepted Auditing Standards (GAAS) The financial statements are the responsibility of management. Our audit was designed in accordance with Canadian generally accepted auditing standards to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audit and to determine the nature, timing, and extent of testing performed.</p>	<p>Upon completion of our remaining audit procedures, we currently expect to issue an unqualified opinion on the City's consolidated financial statements for the year ended December 31, 2007.</p>
<p>Our Judgments About the Quality of the City's Accounting Principles We discuss our judgments about the quality, not just the acceptability, of the accounting policies as applied in the City's financial reporting, including the consistency of the accounting policies and their application and the clarity and completeness of the financial statements and related disclosures.</p>	<p>We believe the quality of accounting policies disclosed in the financial statements and applied in the financial reporting, including the consistency of their application, and the understandability and completeness of the financial statements complies with Canadian generally accepted accounting principles ("GAAP"), Public Sector Accounting and is reasonable in relation to industry practice.</p>
<p>Sensitive Accounting Estimates and Disclosures The preparation of the financial statements requires the use of accounting estimates. Certain estimates and disclosures are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's current judgments. We determine that the Committee is informed about management's process for formulating particularly sensitive accounting estimates and about the basis for our conclusions regarding the reasonableness of those estimates.</p>	<p>The accounting estimates we considered as sensitive are those surrounding the valuation of the landfill obligation, contingencies, the provision for employee future benefits, property tax provisions and property tax rebates. We have provided our views in the preceding section titled "Findings and Observations - financial statements accounts and disclosures".</p>
<p>The Adoption of, or a Change in an Accounting Principle We determine that the Committee is informed about the initial selection of, and any changes in, significant accounting principles or their application when the accounting principle or its application, including alternative methods of applying the accounting principle, has a material effect on the financial statements.</p>	<p>No new accounting policies were adopted in fiscal 2007.</p>
<p>All Material Alternative Accounting Treatments Discussed with Management We report to the Committee all alternative accounting treatments within GAAP for policies and practices related to material items (including recognition, measurement, presentation and disclosure alternatives) that have been discussed with management during the current audit period including the acceptability of the policies or methods ultimately retained by management.</p>	<p>None.</p>

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Area	Comments
<p>Methods of Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas</p> <p>We determine that the Committee is informed about the methods used to account for significant unusual transactions and the effects of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.</p>	<p>We are not aware of any significant unusual transactions recorded by the City or of any significant accounting policies used by the City related to controversial or emerging areas for which there is a lack of authoritative guidance.</p>
<p>Significant Audit Adjustments</p> <p>We provide the Committee with information about adjustments arising from the audit (whether recorded or not) that could in our judgment, either individually or in the aggregate, have a significant effect on the City's financial statements.</p> <p>[Note: Our communication includes proposed corrections to interim financial information, as well as significant disclosure items that were addressed principally as a result of the audit.]</p>	<p>All accounting differences identified during the audit were discussed with management and unrecorded accounting differences individually or in the aggregate are not significant to the financial statements. We have attached to this report our Summary of Audit Differences ("Appendix C").</p>
<p>Unrecorded Audit Differences Considered by Management to Be Immaterial</p> <p>We inform the Committee about unrecorded audit differences accumulated by us (i.e., adjustments either identified by us or brought to our attention by management) during the current audit and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole.</p>	<p>Refer to "Summary of Audit Differences" ("Appendix C").</p>
<p>Fraud and Illegal Acts</p> <p>We report to the Committee fraud and illegal acts involving senior management and fraud and illegal acts (whether caused by senior management or other employees) that cause an other than trivial misstatement of the financial statements.</p> <p>[Note: In addition, we discuss any misappropriations perpetrated by lower-level employees, based on our understanding with the Committee regarding the nature and extent of communications with the committee about such matters.]</p>	<p>We are not aware of matters that require communication. Refer to "Fraud Considerations" section for more information about our procedures related to fraud.</p>
<p>Significant Weaknesses in Internal Control</p> <p>We communicate all significant weaknesses in internal control over financial reporting that may have been identified during the course of our audit.</p>	<p>No significant weaknesses were identified. Control deficiencies found have been documented in a management letter which will be forwarded once the review with management has been completed.</p>
<p>Other Information in Documents Containing Audited Financial Statements</p> <p>Our financial statement audit opinion relates only to the financial statements and notes. However, we also review other information in the Annual Report, such as Management's Discussion and Analysis, for consistency with the audited financial statements.</p>	<p>Once it is complete, we will review the City's Annual Report for consistency between the audited financial statements and other sections of that document.</p>
<p>Disagreements with Management</p>	<p>None.</p>
<p>Serious Difficulties Encountered in Dealing with Management when Performing the Audit</p>	<p>None.</p>
<p>Major Issues Discussed with Management in Connection with Initial or Recurring Retention</p>	<p>None.</p>
<p>Consultation with Other Accountants</p>	<p>None of which we are aware.</p>

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<p>Related Party Transactions</p> <p>Related party transactions identified by the auditor that are not in the normal course of operations and that involve significant judgments made by management concerning measurement or disclosure must be disclosed to the Committee.</p>	All related party transactions of which we are aware are disclosed in the financial statements.
<p>Matters Relating to Component Entities of the City</p> <p>When the financial statements of a City (primary entity) include financial information from financial statements of a component entity (a subsidiary, investee (other than a portfolio investment), or joint venture; or an entity whose financial information from financial statements is included with those of the primary entity), the auditor communicates with the Committee those matters relating to the component entities that in the auditor's judgment are of significance in the context of the primary entity (for example, weaknesses in systems of internal control that have resulted, or could result, in material errors in the primary entity's consolidated financial statements).</p>	None of which we are aware.
<p>Fees and Related Regulatory Disclosures</p> <ul style="list-style-type: none"> • Under our professional standards, we are required to disclose to the Committee the total fees charged for audit and non-audit services provided by us and by our related businesses or practices to the City and its related entities. 	<p>During the period from January 1, 2007 through December 31, 2007, Ernst & Young charged \$358K for audit services including:</p> <ul style="list-style-type: none"> • Audit of the City of Ottawa • Audit of the Pineview Golf Course • Audit of the Sinking Fund • Audit of the City of Ottawa Superannuation Fund • Audit of the OC Transpo pension and benefit trust • Audit of numerous public health programs, annual expenditure programs and business improvement areas. <p>These amounts do not include fees charged to Ottawa Community Housing Corporation or Hydro Ottawa during the period.</p>
<p>Independence</p> <p>We communicate, at least annually, the following to the Committee:</p> <ul style="list-style-type: none"> • Disclose, in writing, all relationships between Ernst & Young and our related entities and the City and its related entities that, in our professional judgment, may reasonably be thought to bear on independence; • Confirm in writing that, in our professional judgment, we are independent of the City within the meaning of the [Client Team TBD - Rules of Professional Conduct / Code of Ethics of the provincial institutes]; and • Discuss with the Committee any matters that in our professional judgment may reasonably be thought to bear on our independence. 	We are required to confirm our independence to Committees pursuant to CICA 5751. The Standard requires us to make a written communication regarding our independence even if we conclude that there are no matters that may reasonably be thought to bear on independence. ("Appendix B")
<p>Fraud</p> <p>We communicate, at least annually, the following to the Committee:</p> <ul style="list-style-type: none"> • We report to the Committee fraud and illegal acts involving senior management and fraud and illegal acts (whether caused by senior management or other employees) that cause a material misstatement to the financial statements • We are also required to make inquiries of the Audit related to fraud, including both (1) their views about the risks of fraud, and (2) their knowledge of any actual or suspected fraud. 	We are not aware of any matters that require communication based on our audit procedures performed on the consolidated financial statements. We would request that the Committee members raise with us any areas of risk not addressed in our communications and that they inform us of their knowledge of any actual or suspected fraud

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APPENDIX A—TABLE OF REQUIRED COMMUNICATIONS WITH COMMITTEES

For reference purposes, communication requirements with Committees are summarized below.

	Communicate When Event Occurs	Communicate On a Timely Basis, At Least Annually	Communicate Prior to Completion of Audit
Communications Required on All Audits:			
Audit and Non-Audit Services Provided to The Entity and Related Entities			CICA 5751.
Our Responsibility Under GAAS, Including Other Information in Documents Containing Audited Financial Statements		CICA 7500	CICA 5751
Our overall audit strategy			CICA 5751
Fraud and Illegal Acts Involving Senior Management and Fraud and Illegal Acts that Cause an Other Than Trivial Misstatement of the Financial Statements		CICA 5135 and 5136	
Significant Weaknesses in Internal Control	CICA 5220		
Related Party Transactions		CICA 6010	
Significant Audit Adjustments		CICA 5751	
Unadjusted Audit Differences Considered by Management to Be Immaterial		CICA 5751	
The Adoption of, or a Change in, an Accounting Principle, Including Material Alternative Accounting Treatments Discussed With Management and Acceptability of Particular Policy used by Management		CICA 5751	
Methods of Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas		CICA 5751	
Our Judgments About the Quality of the City's Accounting Principles		CICA 5751	
Sensitive Accounting Estimates and Disclosures, Including Basis for Our Conclusions Regarding Reasonableness of Those Estimates		CICA 5751	
Matters Relating to Component Entities of the City		CICA 5751	
Disagreements with Management		CICA 5751	
Consultations with Other Accountants		CICA 5751	
Major Issues Discussed with Management in Connection with Initial or Recurring Retention		CICA 5751	
Serious Difficulties Encountered in Dealing with Management When Performing the Audit		CICA 5751	
Communication of Independence Matters		CICA 5751	CICA 5751

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APPENDIX B—INDEPENDENCE

June 17, 2008

Members of the Corporate Services and Economic Development Committee
City of Ottawa

We have been engaged to audit the consolidated financial statements of the City of Ottawa (the “City”) for the year ending December 31, 2007.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the City and us that, in our professional judgment, may reasonably be thought to bear on our independence.

In determining which relationships to report, these standards require us to consider relevant rules and related interpretations prescribed by the appropriate provincial institute and applicable legislation, covering such matters as:

- (a) holding a financial interest, either directly or indirectly, in a client;
- (b) holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
- (c) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
- (d) economic dependence on a client; and
- (e) provision of services in addition to the audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters.

We are not aware of any relationships between the City and us that, in our professional judgment, may reasonably be thought to bear on our independence, that have occurred from June 19, 2007, date of our last independence letter, to the date of this letter.

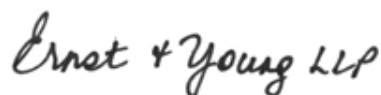
The total fees for audit services, other audit related services and other professional services performed during the year ended December 31, 2007 amount to \$358,550.

GAAS require that we confirm our independence to the committee in the context of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario. Accordingly, we hereby confirm that we are independent with respect to the City within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of the date of this letter.

This report is intended solely for the use of the Committee and management, and others within the City and should not be used for any other purposes.

We look forward to discussing with you the matters addressed in this letter.

Very truly yours,



Chartered Accountants
Licensed Public Accountants

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APPENDIX C—SUMMARY OF AUDIT DIFFERENCES

During the course of our audit, we accumulated the following audit differences:

<u>Unrecorded Differences</u>	Overstatement (Understatement) of Net revenues (thousands of dollars)
Employee future benefits expenditures	(6,165)
Transit capital expenditures	(2,795)
Drug benefit expenditures	(2,008)
Lease inducement revenue	(239)
Property tax assessment appeals provision	3,600
Social services expenditures	798
WSIB liability	239
Net effect of 2006 unadjusted differences – turnaround impact	<u>(14,265)</u>
	(20,835)
<u>Recorded Differences</u>	
Accrued liabilities related to a legal obligation	(2,025)

Misclassifications identified in the Financial Statements

Recorded

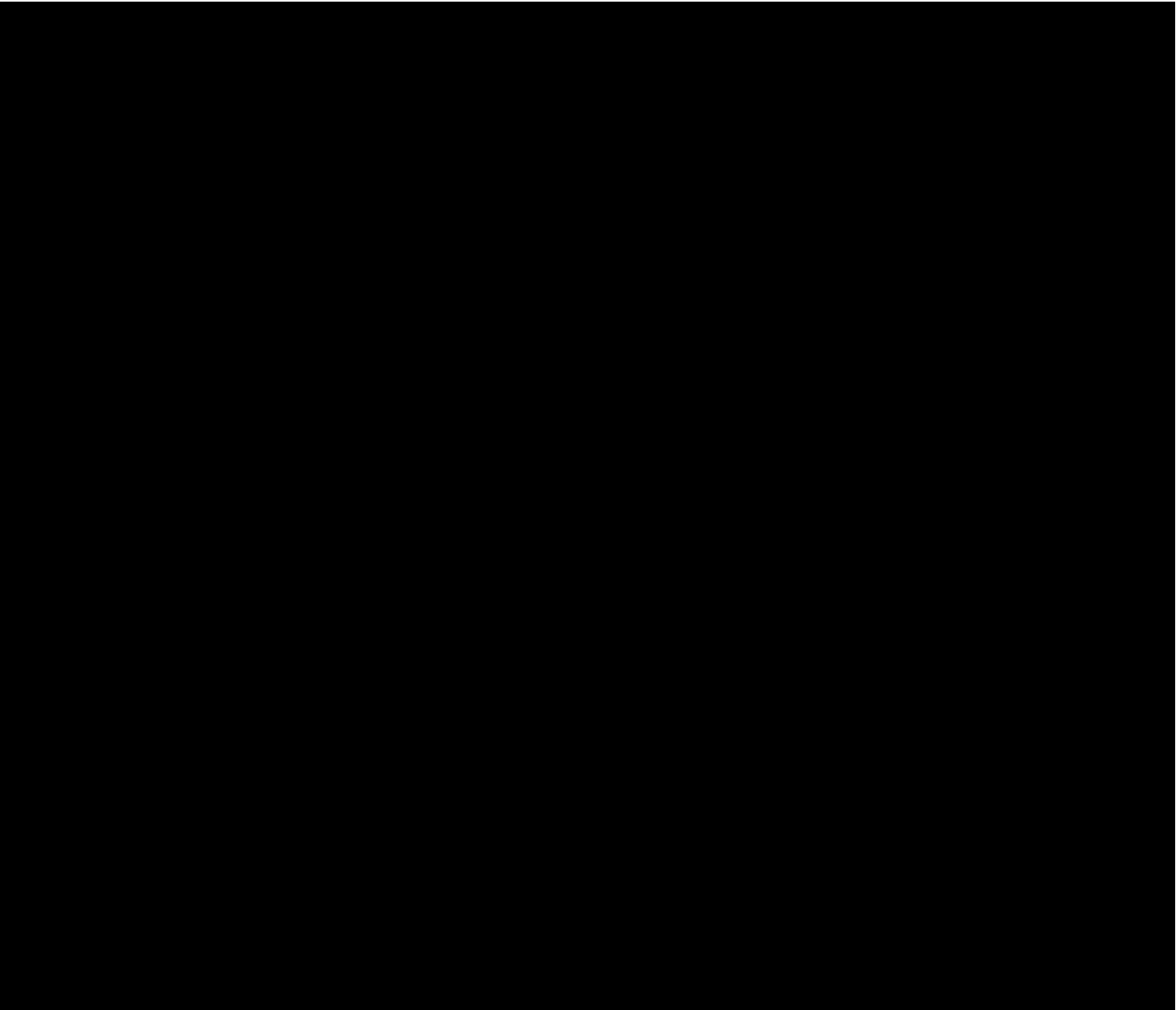
- \$32.2M of short-term investments with terms less than 90 days were reclassified from investments to cash and short-term investments.

Unrecorded

- Understatement of amounts to be recovered and capital lease obligation of approx. \$7.8M related to the Ottawa Paramedic Services lease obligation.
- Understatement of WSIB liability and amounts to be recovered of approx. \$3.1M related to an Ottawa Police WSIB account identified during the audit.
- Understatement of deferred revenue and overstatement of the operating fund balance of approx. \$5.1M related to tenant inducement amortized to the statement of operations too quickly.

Conclusion

Management has concluded that the unrecorded differences are not material and we have concurred.



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