The District of Highlands

Audit Findings Report

For the year ended December 31, 2016

For meeting on May 1, 2017

kpmg.ca/audit

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Executive summary

Purpose of this report

The purpose of this Audit Findings Report is to assist you, as a member of the Council, in your review of the results of our audit of the financial statements of the District of Highlands as at and for the year ended December 31, 2016.

Scope of the audit

The purpose of an audit is to enhance the degree of confidence of the users of the financial statements through the expression of an opinion on whether the financial statements fairly present, in all material respects, the financial position, results of operations, and cash flows of the District in accordance with Public Sector accounting standards.

In planning our audit, we have considered the level of audit work required to support our opinion, including each of the following matters:

Materiality

We determine materiality in order to plan and perform the audit and to evaluate the effects of identified misstatements on the audit and of any uncorrected misstatements on the financial statements.

For the current period, materiality of $75,000 has been determined (2015 - $75,000).

Adjustments and differences

We did not identify differences that remain uncorrected.

We identified adjustments that were communicated to management and subsequently corrected in the financial statements.

Control and other observations

We did not identify any control deficiencies that we determined to be significant deficiencies in internal controls.

Finalizing the audit

As of April 27, 2017, we have completed the audit of the financial statements, with the exception of certain remaining procedures, which include amongst others:

- completing our discussions with Council;
- obtaining evidence of the Council's approval of the financial statements.
- receipt of the signed management representation letter

We will update the Council on significant matters, *if any*, arising from the completion of the audit, including the completion of the above procedures. Our auditors' report will be dated upon the completion of any remaining procedures.

Audit risks and results

Included in this section are significant matters we believe are appropriate for discussion at the upcoming Council meeting. We look forward to discussing these matters and our findings with you.

Planned audit procedures and results

There were no significant financial reporting risks identified during our audit planning. We have highlighted below procedures performed over significant accounts based on our risk assessment and audit strategy.

Audit Approach

- The KPMG audit methodology includes obtaining an understanding of the various processes within the District including budgeting, revenue, procurement, payroll, and information technology.
- Applying this understanding, we perform analytical analysis over the statement of financial position and the statement of operations and fund balances. In this analysis, support for significant variances provided by management, from both prior year and budget, is tested for completeness and accuracy to ensure the reliability of the underlying data.
- We also perform substantive analytical procedures over revenue and expenses, as well as detailed testing over government transfers and the cut-off of expenses and accruals at year end.
- Government transfer revenues and deferred revenues were substantively tested by obtaining grant terms and conditions and testing to determine if the criteria in relation to the grants had been met.
- We obtain external confirmation on all significant cash and investment balances and test reconciling items as recorded in the general ledger.
- Tangible capital asset additions and amortization were substantively tested.
- We perform a predictive procedure over the payroll expense for the year based on approved budget and known payroll changes in the period.
- Due to the public nature of the District we substantively test expense reports for senior management and council members
- Financial statement disclosures were reviewed for appropriateness of presentation and disclosure under Public sector accounting standards.

Audit risks and results (continued)

Significant accounting policies and practices

Significant accounting policies and practices are disclosed in Note 1 to the financial statements. There have been no initial selections of, or changes to, significant accounting policies and practices to bring to your attention in the current period.

Financial statement presentation and disclosure

The presentation and disclosure of the financial statements are, in all material respects, in accordance with the Districts' relevant financial reporting framework. Misstatements, including omissions, if any, related to disclosure or presentation items are in the management representation letter included in the Appendices.

Other matters

We have highlighted below other significant matters that we would like to bring to your attention:

Donation of Land	KPMG comment
• In 2013, land dedicated for park was donated to the District by a developer and was not recorded in the District's financial records as an increase to land and donation revenue. • The valuation of the land performed by the BC Assessment Authority in 2014 was $275,000. This was based on the lands' classification as residential, rather than as dedicated for parks. In estimating a more appropriate value, management identified three similar properties (undeveloped park land within the District), and used the average value per acre to provide an estimate of the value of the land. The estimate totaled $32,000 and was an unadjusted proposed entry in prior year. • In 2016, BC Assessment reclassified this donated property as park land and assessed the value of the property to be $66,600.	• KPMG obtained supporting documentation for the valuation of the donated land. • Management recorded donation revenue and donated land in 2016 for the difference in values. • We concur with this treatment

MFA Debt Issuance	
• In May 2016 Council authorized the District to borrow $500,000 from MFA to fund the cost of purchasing one (1) new Single Axle, 1800-2000 Gallon Tender and for the cost to construct a new bay addition to the West Fire Hall on Millstream Road. • The financing from MFA was received by the Municipality in October 2016. • This loan requires annual principal payments of $43,615 with interest of $5,250 per year.	• KPMG noted that the issuance of new debt was appropriately authorized by Council through Bylaw 382. • KPMG confirmed the balance outstanding as at December 31, 2016 and performed a covenant analysis and noted that the District is in line with the Community Charter debt covenant requirements.

Adjustments and differences

Corrected adjustments

Please refer to Management's representation letter in the Appendices for all audit adjustments. We highlight the following adjustments:

- To record the actuarial adjustment on MFA debt of $13,314
- To recognize interest income of $10,136 that was initially recorded directly to the reserve funds.
- To record the cash reserve on the new MFA debt totalling $5,279
- To recognize $29,335 loss on disposal of assets
- Minor changes to financial statement presentation and disclosure were suggested and accepted by management.

Uncorrected differences

We did not identify differences that remain uncorrected.

Control observations

Significant deficiencies

We did not identify any control deficiencies that we determined to be significant deficiencies in internal controls over financial reporting (ICFR).

Appendices

Appendix 1: Required communications

Appendix 2: Financial comparatives

Appendix 3: Audit Quality and Risk Management

Appendix 4: Current developments

Appendix 1: Required communications

In accordance with professional standards, there are a number of communications that are required during the course of and upon completion of our audit. These include, in addition to this report:

– **Auditors' report** – the conclusion of our audit is set out in our draft auditors' report

– **Management representation letter** –In accordance with professional standards, copies of the management representation letter are provided to the Council.

May 1, 2017

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 District of Highlands ("the Entity") as at and for the period ended December 31, 2016.

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 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:

GENERAL:

1) We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated March 23, 2016, 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 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 the 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

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

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 Entity 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 Entity's financial statements, communicated by employees, former employees, 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

SUBSEQUENT EVENTS:

4) 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:

5) We have disclosed to you the identity of the Entity's related parties and all the related party relationships and transactions / balances of which we are aware and all related party relationships and transactions / balances have been appropriately accounted for and disclosed in accordance with the relevant financial reporting framework.

ESTIMATES:

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

MISSTATEMENTS:

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

OTHER:

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

9) The Home Owner Grant Certificate has been prepared and presents fairly the Home Owner Grant information in accordance with the provisions of Section 12 of the Home Owner Grant Act.

Yours very truly,

DISTRICT OF HIGHLANDS

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By: Ms. Loranne Hilton, CAO

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 an entity'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 *related party* is defined as:

- one party that 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.

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.

Attachment II – Summary of Audit Misstatements

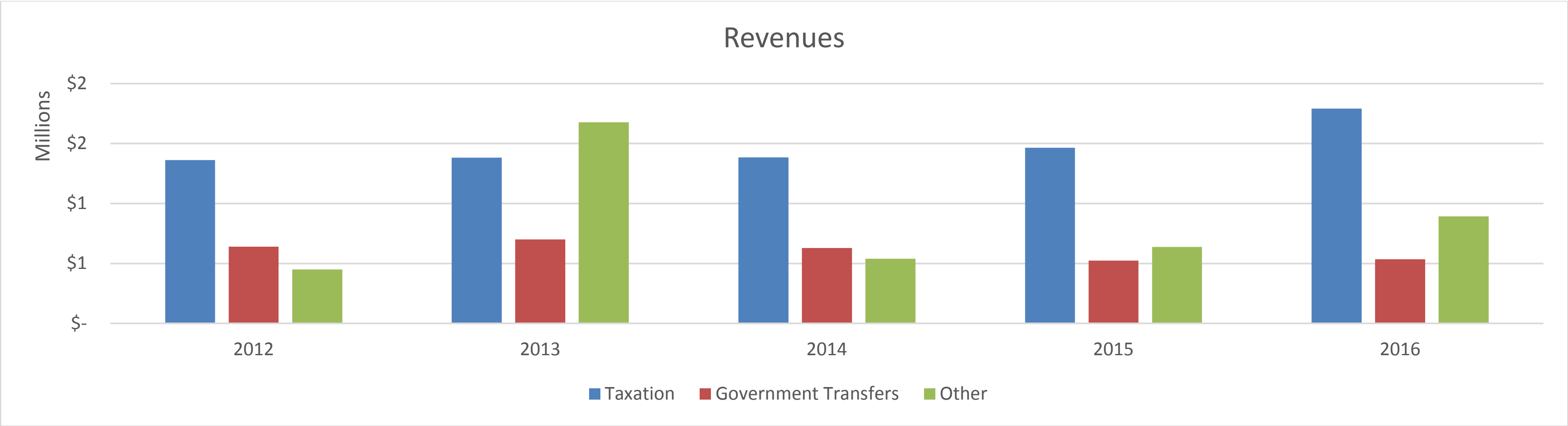
Corrected Audit Misstatements

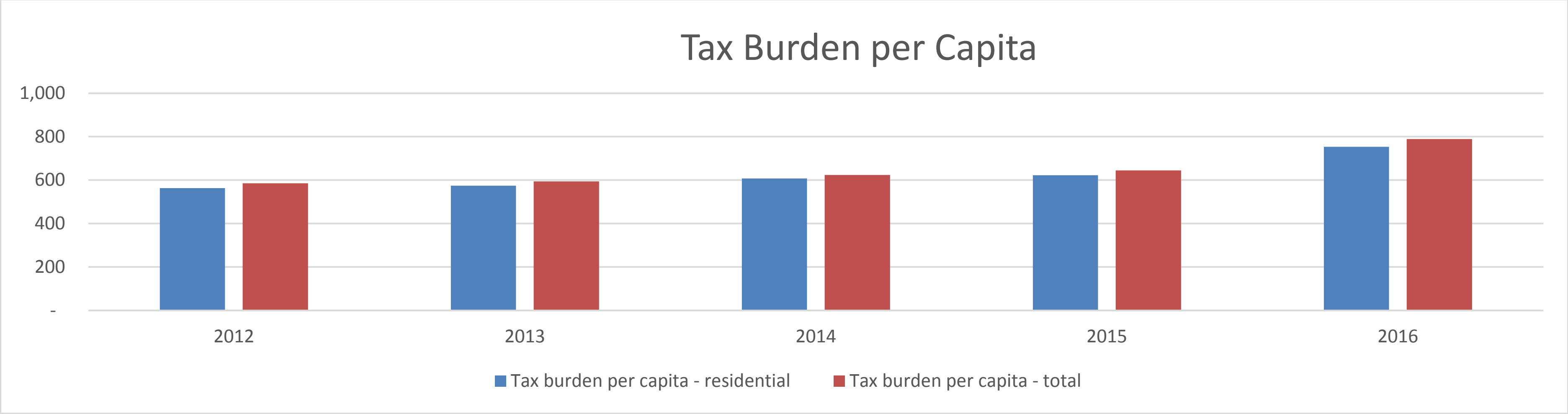
		Income effect	Financial position		
Description	**F/J/P**	**(Decrease) Increase**	**Assets (Decrease) Increase**	**Liabilities (Decrease) Increase**	**Equity (Decrease) Increase**
To recognize the loss on disposal of the old East Fire Hall	F	(29,335)	-	-	(29,335)
To recognize interest income earned on reserve accounts	F	10,136	-	-	10,136
To record actuarial adjustment on MFA debt	F	13.314	-	-	13,314
To remove unspent debt from deferred revenue (reclass)	F	-	-	(157,201) 157,201	
West Shore consolidation and other presentation entries proposed and adjusted					
Total		**(5,885)**	**-**	**-**	**(5,885)**

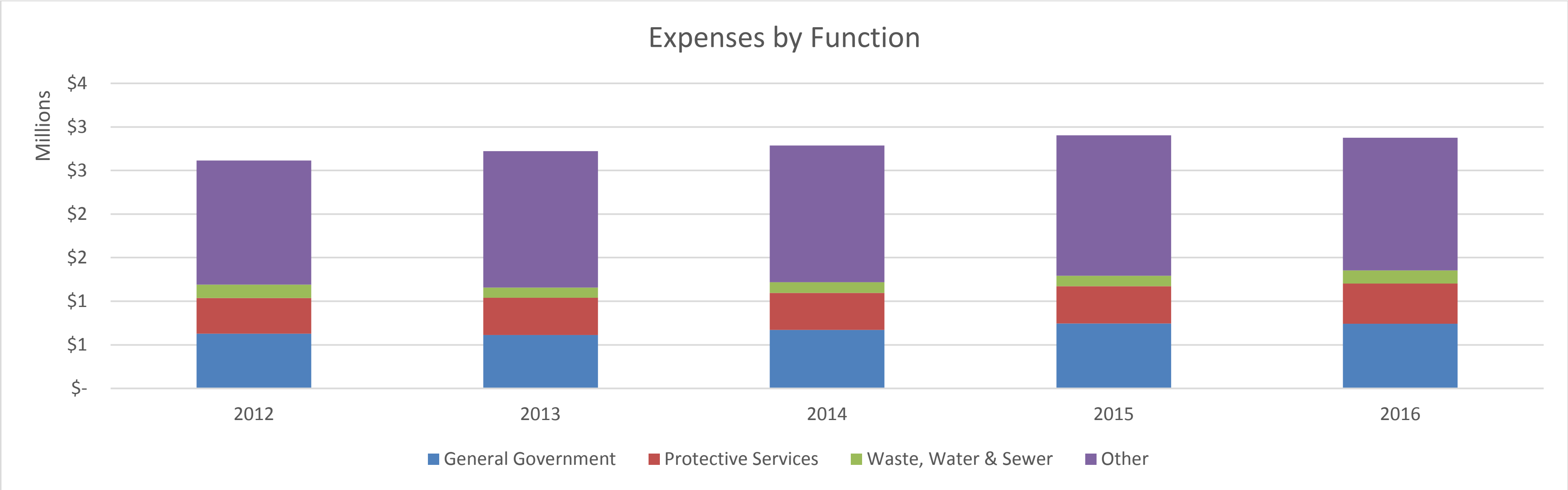
F (Factual); J (Judgmental); P (Projected)

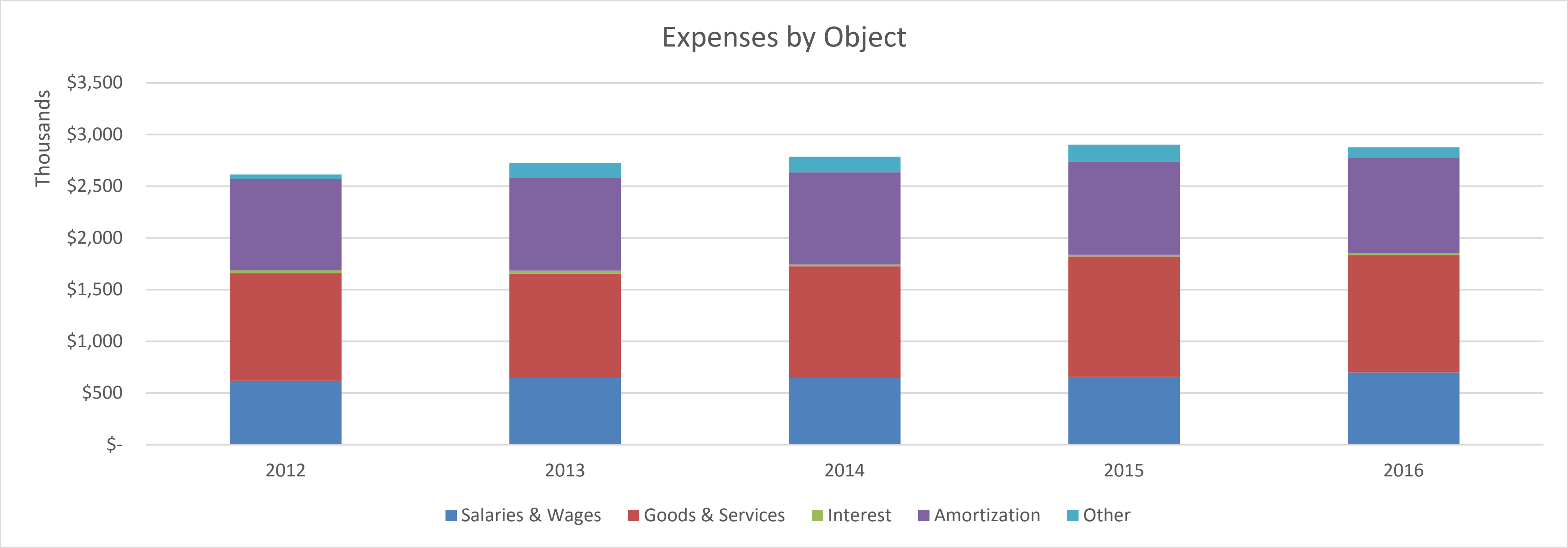
Appendix 2: Financial comparatives

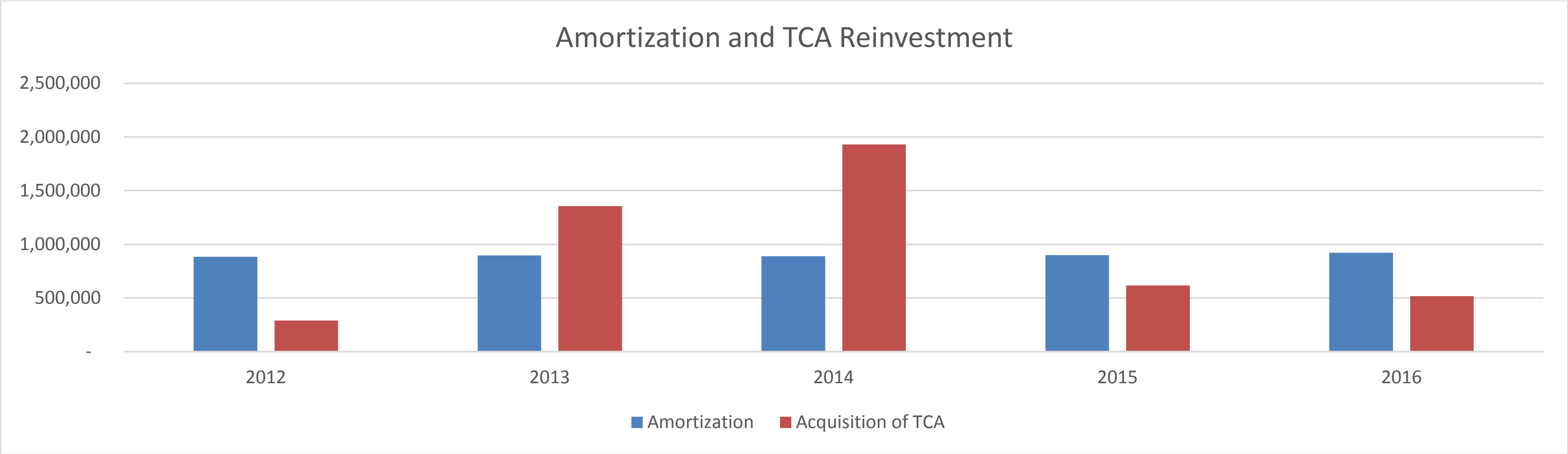
Information relative to trends on financial comparatives specific to the District of Highlands

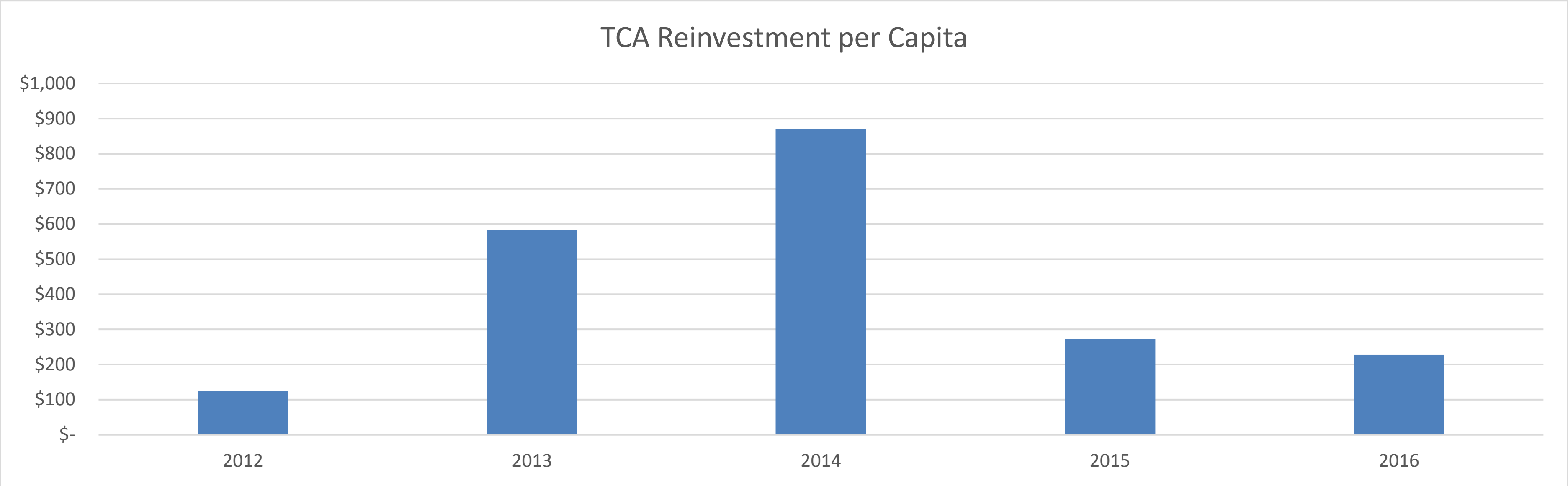


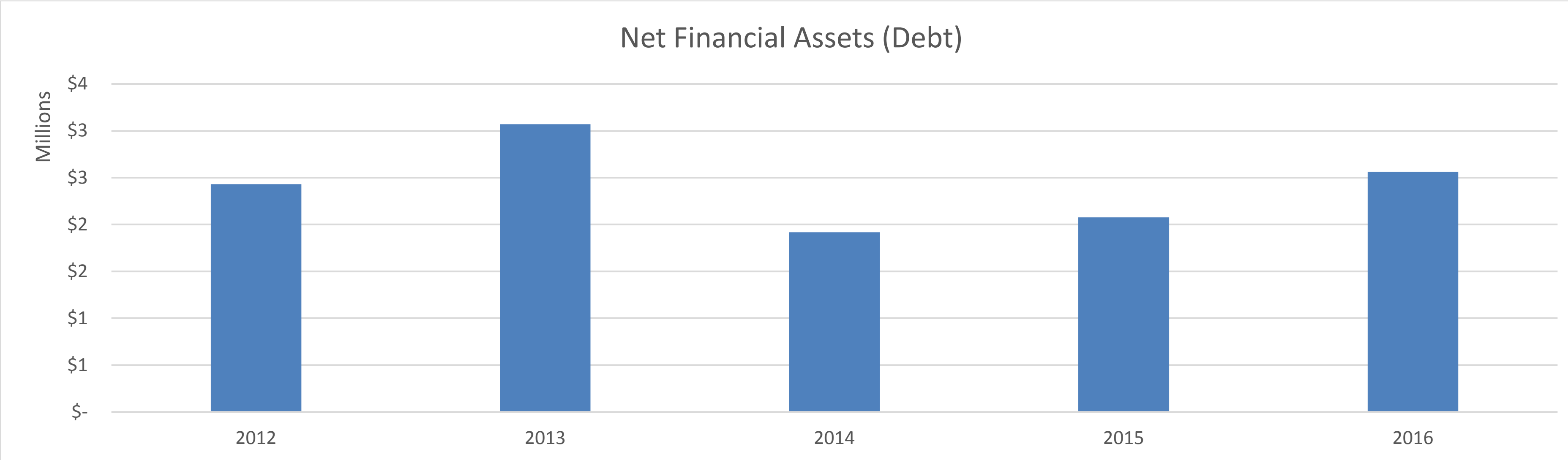



Expenses by Function
Millions
$4
$3
$3
$2
$2
$1
$1
$-
2012
2013
2014
2015
2016
General Government
Protective Services
Waste, Water & Sewer
Other

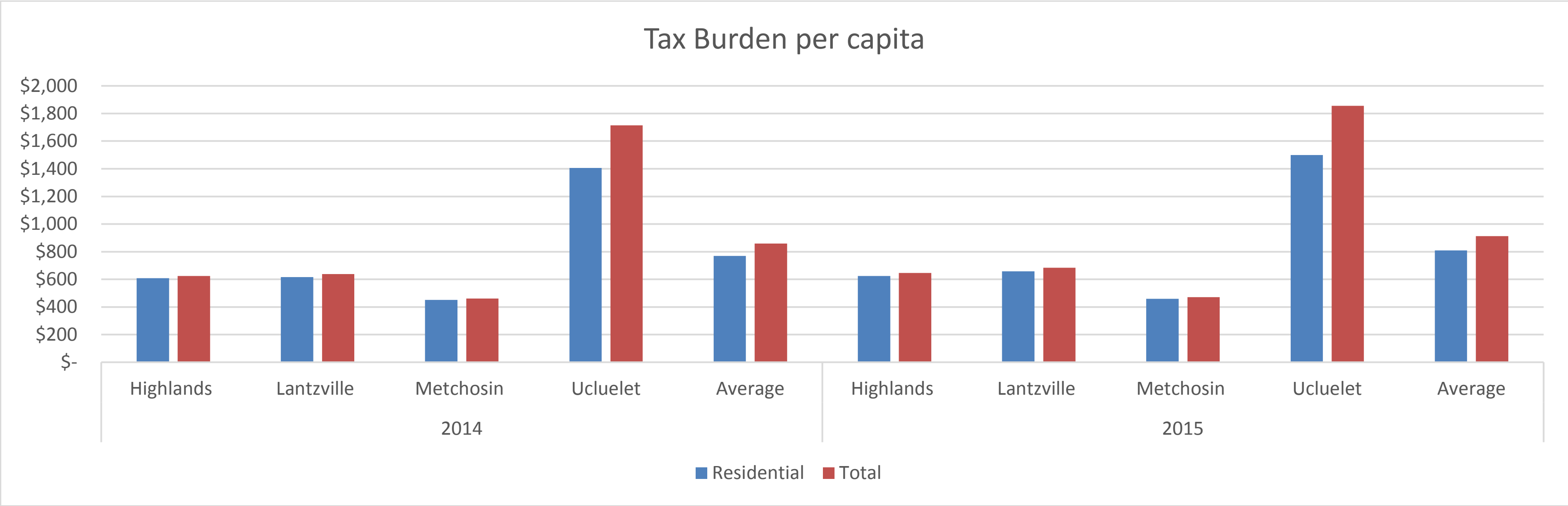

Expenses by Object
Thousands
$3,500
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$-
2012
2013
2014
2015
2016
Salaries & Wages
Goods & Services
Interest
Amortization
Other

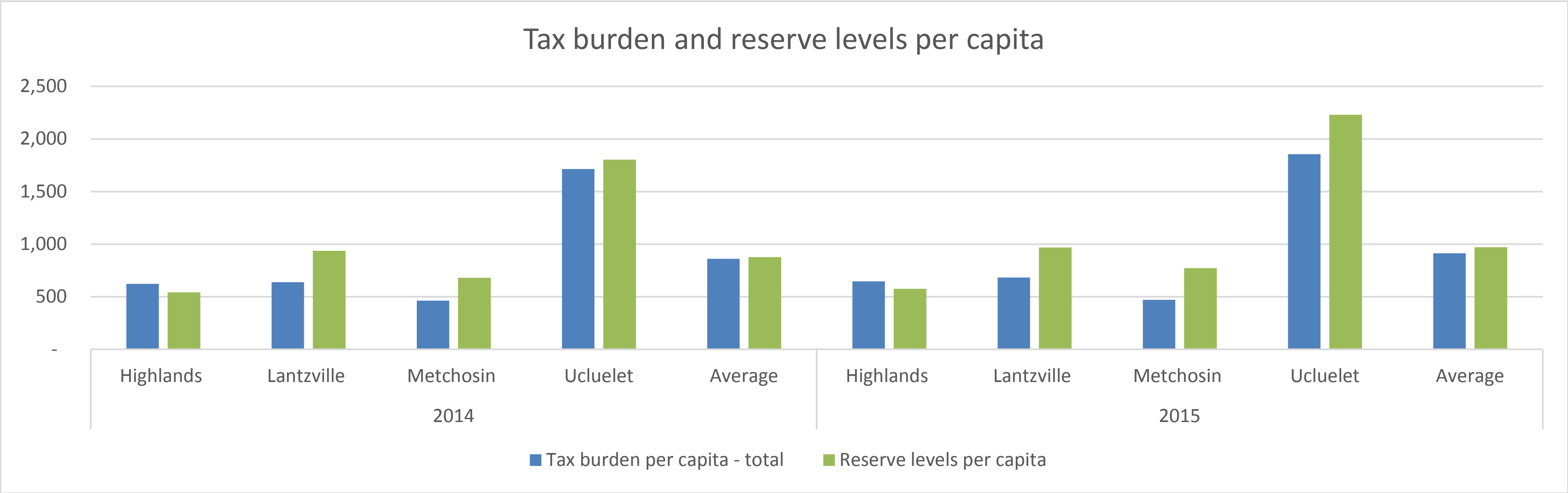

Amortization and TCA Reinvestment
2,500,000
2,000,000
1,500,000
1,000,000
500,000
-
2012
2013
2014
2015
2016
Amortization
Acquisition of TCA


TCA Reinvestment per Capita
$1,000
$900
$800
$700
$600
$500
$400
$300
$200
$100
$-
2012
2013
2014
2015
2016


Net Financial Assets (Debt)
Millions
$4
$3
$3
$2
$2
$1
$1
$-
2012
2013
2014
2015
2016

Information relative to trends on financial comparatives as compared to similar sized local governments for fiscal 2014 and 2015





Appendix 3: Audit Quality and Risk Management

KPMG maintains a system of quality control designed to reflect our drive and determination to deliver independent, unbiased advice and opinions, and also meet the requirements of Canadian professional standards.

Quality control is fundamental to our business and is the responsibility of every partner and employee. The following diagram summarises the six key elements of our quality control systems.

Visit our [Audit Quality Resources page] for more information including access to our audit quality report, [Audit quality: Our hands-on process.]

- Other controls include:
  - Before the firm issues its audit report, the Engagement Quality Control Reviewer reviews the appropriateness of key elements of publicly listed client audits.
  - Technical department and specialist resources provide real-time support to audit teams in the field.
- We conduct regular reviews of engagements and partners. Review teams are independent and the work of every audit partner is reviewed at least once every three years.
- We have policies and guidance to ensure that work performed by engagement personnel meets applicable professional standards, regulatory requirements and the firm's standards of quality.
- All KPMG partners and staff are required to act with integrity and objectivity and comply with applicable laws, regulations and professional standards at all times.

- We do not offer services that would impair our independence.
- The processes we employ to help retain and develop people include:
  - Assignment based on skills and experience;
  - Rotation of partners;
  - Performance evaluation;
  - Development and training; and
  - Appropriate supervision and coaching.
- We have policies and procedures for deciding whether to accept or continue a client relationship or to perform a specific engagement for that client.
- Existing audit relationships are reviewed annually and evaluated to identify instances where we should discontinue our professional association with the client.

Appendix 4: PSAB Current developments

Standard	Summary and implications
Related Party Transactions 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.

Standard	Summary and implications
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.
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. PSAB currently contains no specific guidance in this area. — 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”). An ARO liability would initially be recorded at its fair value (normally estimated using a present value technique) at the time of acquisition or construction of the TCA. The liability is subsequently increased or “accreted” up to the settlement date using an effective interest rate (normally the rate used to estimate the present value of the liability) with the corresponding debit amount being expensed. — A corresponding addition to the carrying amount of TCA is recognized at the same time as the ARO liability, which would then be amortized over the TCA’s useful life. The net effect is an increase in TCA and ARO liability upon recognition, and over time, an increase in amortization expense and accretion expense. — As a result of the proposed standard, the public sector entity will 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 standard has a proposed effective date of April 1, 2021.
Public Private Partnerships	— 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 phased approach will address the definition and measurement of transactions with P3s. A Statement of Principles is anticipated in 2017.

ALLOWANCES FOR MEMBERS OF LEGISLATIVE ASSEMBLIES AND CERTAIN MUNICIPAL OFFICERS

- The reimbursement of expenses incurred in the course of carrying out the duties of an office or employment is generally not a taxable benefit to the recipient. By contrast, a non-accountable allowance for which an individual does not have to provide details or submit receipts to justify amounts paid is generally a taxable benefit.
- Certain officials may, however, receive non-accountable allowances for work expenses that are not included in computing income for tax purposes. These officials are:
  - elected members of provincial and territorial legislative assemblies and officers of incorporated municipalities;
  - elected officers of municipal utilities boards, commissions, corporations or similar bodies; and
  - members of public or separate school boards or of similar bodies governing a school district.
- The excluded amount is limited to half of the official's salary or other remuneration received in that capacity in the year.
- The 2017 Federal Budget proposes to require that non-accountable allowances paid to these officials be included in income. The reimbursement of employment expenses will remain a non-taxable benefit to the recipient.
- In order to provide affected organizations more time to adjust their compensation schemes, this measure will apply to the 2019 and subsequent taxation years.

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