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January 20, 2010

Members of the Audit Committee
City of Kenora
1 Main Street South
PO Box 1100
Kenora, ON
P9N 3X2

**Re: Audit of the Financial Statements of City of Kenora
For the year ended December 31, 2009**

Dear Sirs,

The purpose of this report is to communicate to the Audit Committee certain aspects of the audit that we believe would be of interest to you. The Audit Committee can play an important part in the audit planning process and we look forward to discussing our proposed plan with you to determine whether there are additional areas of concern to the Audit Committee which we should consider.

This report should not be distributed without our prior consent. We accept no responsibility to a third party who uses this communication.

Current Developments in the Profession

Accounting Standards

The Canadian Institute of Chartered Accountants (CICA) has issued a number of new accounting standards. Below, we have briefly outlined those which will impact your organization for 2009:

PS1000, PS1100 and PS1200

PS 1000, PS 1100 and PS 1200, are collectively referred to as the Government Financial Reporting Model. The new Government Financial Reporting Model is an "accrual basis of accounting". This model of accounting recognizes the financial effects of transactions in the period(s) in which they occur, irrespective of whether cash has been received or paid.

The new reporting model will have an impact on a government's financial statements in two key areas:

1. Non-financial assets must now be recognized. The current model only required the recognition of financial assets. As a result, the acquisition of non-financial assets is not recorded as expenditures in the year of acquisition. They will now be recognized as assets and expensed as they are used.

2. The definition of revenue and expenses is based on increases and decreases in assets and liabilities. This asset and liability approach to recognizing revenue and expenses may result in volatility in the annual surplus or deficit as there is less focus on matching revenue with expenditures as is done with the current reporting model.

The new reporting model will also impact what financial statements are required to be prepared. Under the current reporting model the financial statements consist of: the statement of financial position, statement of financial activities and statement of changes in financial position. Under the new reporting model the following financial statements will be required to be prepared:

- Statement of financial position
- Statement of operations
- Statement of changes in net debt
- Statement of cash flow

The challenge created by the new reporting model is that in most cases local governments do not budget on an “accrual basis” of accounting. Budgets have typically focused on expenditures and the taxation revenue needed to fund those expenditures. The budget process very much matched “modified accrual basis” of accounting of the current reporting model. The presentation of budget information on an accrual basis does not mean that the budget process must be changed to match the “accrual basis” of accounting. However, a process of reconciling the budget to an “accrual basis” will have to be developed if the budget process isn’t changed. If an organization chooses not to modify its budget process to an “accrual basis”, a reconciliation of the official budget to the amounts reported on the statement of operations and statement of changes in net debt must be disclosed in the notes to the financial statements. Such disclosure is required so users understand how the government's results for the period compare to the results it planned and the amounts authorized to accomplish those plans.

PS3150, Tangible Capital Assets

As you are aware PS3150 requires all tangible capital assets to be recognized on the statement of financial position and the related depreciation to be recognized as an expense of the statement of operations. Tangible capital assets are a significant economic resource and a key component in the delivery of government programs. The recording of capital assets will have a significant impact on your financial statements.

Currently, staff are in the process of finalizing capital asset inventory listings for most classes. It will be important that all related measurement/valuation work and amortization calculations be completed as soon as possible to avoid financial statement and audit delays.

Independence

At the core of the provision of external audit services is the concept of independence. Canadian generally accepted auditing standards (GAAS) require us to communicate to the Audit Committee, at least annually, all relationships between BDO Canada LLP (and its related entities) and City of Kenora (and its related entities), that, in our professional judgement, may reasonably be thought to bear on our independence for the forthcoming audit of the organization.

In determining which relationships to report, we have considered the applicable legislation and relevant rules of professional conduct and related interpretations prescribed by the appropriate provincial institute/ordre covering such matters as the following:

- holding of a financial interest, either directly or indirectly in a client;
- 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;
- personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
- economic dependence on a client; and
- provision of services in addition to the external audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters arising since July 6, 2009, the date of our last letter.

We are not aware of any relationships between the organization and us that, in our professional judgement, may reasonably be thought to bear on our independence to date.

The total fees charged to the organization for audit services were \$4,910 and for non-audit services were \$600 during the period from July 6, 2009 to January 20, 2010.

These fees consisted of the following:

• Interim billings with respect to audit services in progress for the year ended December 31, 2009	\$	2,500
• Billings with respect to implementation of PSAB tangible capital assets	\$	2,410
• Review of Form W-8BEN certificate of foreign status	\$	225
• Supply of information on retiring allowances	\$	375

GAAS requires that we confirm our independence to the Audit 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 City of Kenora within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of January 20, 2010.

Responsibilities of the Auditor

It is important for the Audit Committee to understand the responsibilities that rest with the organization and its management and those that belong to the auditor:

- Management is responsible for the preparation of the consolidated financial statements, which includes responsibilities related to internal control, such as designing and maintaining accounting records, selecting and applying accounting policies, safeguarding assets and preventing and detecting fraud and error;
- The auditor's responsibility is to express an opinion on the consolidated financial statements based on an audit thereof;
- An audit is performed to obtain reasonable, but not absolute, assurance as to whether the consolidated financial statements are free of material misstatement and, owing to the inherent limitations of an audit, there is an unavoidable risk that some misstatements of the financial statements will not be detected (particularly intentional misstatements concealed through collusion), even though the audit is properly planned and performed;
- The audit includes:
 - (i) obtaining an understanding of the entity and its environment including internal control in order to plan the audit and to assess the risk that the consolidated financial statements may contain misstatements that, individually or in the aggregate, are material to the financial statements taken as a whole;
 - (ii) examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
 - (iii) assessing the accounting principles used and their application; and
 - (iv) assessing the significant estimates made by management;
- When the auditor's risk assessment includes an expectation of the operating effectiveness of controls, sufficient appropriate audit evidence will be obtained through tests of controls to support the assessment, but the scope of the auditor's review of internal control will be insufficient to express an opinion as to the effectiveness or efficiency of the entity's controls; and
- The auditor will express an opinion as to whether the consolidated financial statements present fairly in all material respects, in accordance with Canadian generally accepted accounting principles, the financial position, results of operations and cash flows of the entity.

Audit Approach

We have been engaged to perform the audit of the consolidated financial statements of City of Kenora for the year ended December 31, 2009. We will adopt an audit approach that allows us to issue an audit opinion on the consolidated financial statements of the organization in the most cost effective manner, while still obtaining the assurance necessary to support our audit opinion.

BDO Canada LLP follows a risk based approach. This approach focuses on obtaining sufficient appropriate audit evidence to reduce the risk of material misstatement in the financial statements to an appropriately low level. This means that we focus our audit effort in areas that we believe have a higher risk of being materially misstated and do less audit work in areas that are only low risk.

To assess risk accurately, we need to have a clear understanding of the organization's business and the environment it operates in. Much of our understanding is obtained through discussions with management and their staff. We would appreciate any information that you could provide to us about your business, industry, competitive marketplace, internal controls, oversight of management's processes relating to fraud and error, or anything else that you feel is important to the audit as it may corroborate what we have already learned from management and other sources, or it may be new information to us. We would also appreciate any insights that you could provide to us on what you perceive to be risky in your organization as that will make our audit more effective and efficient, which will benefit all concerned. In particular we are interested in any knowledge you have regarding actual, suspected or alleged fraud affecting the entity.

Requests by the Audit Committee

In the course of your duties as the Audit Committee, you may be aware of additional areas of concern from an audit perspective that you would like us to address. We want you to know that we welcome discussion on any areas of audit concern that you may have.

Overall Audit Strategy

The general audit strategies available to us are a "combined" audit approach or a "substantive" audit approach.

In a combined audit approach, we would obtain our assurance from a combination of tests of controls (compliance procedures) and substantive procedures (such as analysis of data and obtaining direct evidence as to the validity of the items). The combined strategy is more appropriate when there is a large number of transactions and when controls in the organization are strong. By obtaining some of our assurance from tests of controls, we can reduce the substantive procedures that need to be done. Under a substantive audit approach, all of our audit evidence is obtained through substantive procedures like analysis, confirmation, examination of documentary or electronic evidence, etc.

Based on our knowledge and experience with your organization and a preliminary review of your internal controls, we anticipate using a combined approach.

We plan to test the operating effectiveness of controls in the following transaction streams:

- purchases
- payroll
- sewer and water revenues

Assuming these controls are operating effectively, we will reduce our substantive procedures in these transaction streams and related financial statement areas.

Higher Risk Financial Statement Areas

Based on our knowledge of the organization's business, our past experience, and knowledge gained from management and you, we have identified the following financial statements areas as having a potentially higher risk of material misstatement.

These risks arise mainly because of the complexity of the accounting rules, the extent of estimation and judgement involved in the valuation of these financial statement areas, and the existence of new accounting pronouncements that affect them. We have also provided a brief summary of how we plan to audit these higher risk areas.

Higher Risk Financial Statement Areas	Proposed Audit Procedures
<ul style="list-style-type: none"> • Allowance for taxes receivable 	<ul style="list-style-type: none"> • Review recoverability as no allowance is made for taxes receivable as tax arrears are recovered through tax sale.
<ul style="list-style-type: none"> • Environmental liabilities and post-closure costs for landfill sites 	<ul style="list-style-type: none"> • Examination of environmental assessments from 3rd parties
<ul style="list-style-type: none"> • Post-employment benefit liabilities 	<ul style="list-style-type: none"> • See below Reliance on a Specialist
<ul style="list-style-type: none"> • Goodwill valuation 	<ul style="list-style-type: none"> • Examination of valuation performed on goodwill in the government business enterprise, Kenora Hydro Electric Corporation Ltd.

Reliance on a Specialist

In order for us to perform adequate audit procedures on certain financial statement areas, we will be relying on the work of, and the report prepared by, Morneau Sobeco, actuaries. Canadian generally accepted auditing standards require us to communicate with the specialist. We propose to discuss the following with Morneau Sobeco, actuaries:

- The objective and nature of the audit engagement and how we intend to use the specialist's findings and report
- Our assessment of the significance and risk aspects of the engagement that will affect the specialist's work
- The requirement to advise us if they have any relationship with the organization which could impair their judgement or objectivity in the conduct of their engagement
- The nature, timing and extent of the specialist's work and our planned review of it, possibly including review of their working papers
- Confirmation that the assumptions used in their calculations are consistent with those used in the prior periods and with industry standards
- Their obligation to advise BDO Dunwoody LLP of any matters up to the estimated audit report date that may affect their calculations and their report

We ask that the appropriate level of management review the data provided to Morneau Sobeco, actuaries and that they also review the assumptions used and results reported by the specialist for reasonableness.

Management Representations

During the course of an audit, management makes many representations to us. These representations may be verbal or written and therefore explicit, or they may be implied through the financial statements. Management may provide representations in response to specific queries from us, or may provide unsolicited representations. Such representations are part of the evidence gathered by us to be able to draw reasonable conclusions on which to base the audit opinion. These representations are documented by including in the audit working papers memoranda of discussions with management and written representations received from management.

Management's representations include, but are not limited to:

- (a) matters communicated in discussions with us, whether solicited or unsolicited;
- (b) matters communicated electronically to us;
- (c) schedules, analyses and reports prepared by the entity, and management's notations and comments thereon, whether or not in response to a request by us;
- (d) internal and external memoranda or correspondence;
- (e) minutes of meetings of the board of directors or similar bodies such as audit committees and compensation committees;
- (f) a signed copy of the financial statements; and
- (g) a representation letter from management.

We will obtain management's written confirmation of significant representations provided to us during the engagement. Such a confirmation includes matters that are:

- (a) directly related to items that are material, either individually or in the aggregate, to the financial statements;
- (b) not directly related to items that are material to the financial statements but are significant, either individually or in the aggregate, to the engagement; or
- (c) relevant to management's judgments or estimates that are material, either individually or in the aggregate, to the financial statements.

Communication of Results

At the completion of our audit, just prior to issuing our Auditors' Report, or earlier if considered necessary, we will communicate to you matters arising from the financial statement audit. Our communication will include the following:

- matters required to be communicated to the Audit Committee under Canadian generally accepted auditing standards including possible fraudulent activities, possible illegal acts, significant weaknesses in internal control and certain related party transactions;
- matters that have a significant effect on the qualitative aspects of accounting principles used in the organization's financial reporting;
- other matters arising from the audit that, in our professional judgement, are important and relevant to the Audit Committee; and
- matters previously agreed with you to be communicated to the Audit Committee.

Conclusion

We hope that this letter will provide you with an update on the current developments within the accounting profession, as well as clarify our independence, responsibility and audit approach.

We look forward to discussing these issues with you. Please do not hesitate to contact us about any of the above items or other matters of concern to the Audit Committee.

Yours Sincerely

BDO Canada LLP
Chartered Accountants, Licensed Public Accountants

Claudine Cordeiro, C.A.
Office Managing Partner

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