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Private & Confidential

February 9, 2011

Members of the Finance & Administration Committee
Town of The Blue Mountains
26 Bridge Street
Box 310
Thornbury, Ontario
N0H 2P0

Dear Committee Members:

**Re: Audit of the Financial Statements of
Town of The Blue Mountains
For the year ended December 31, 2009**

The purpose of this report is to summarize certain aspects of the audit that we believe would be of interest to the Finance & Administration Committee. This report should be read in conjunction with the financial statements and our report thereon, and it is intended solely for the use of the Finance & Administration Committee and should not be distributed to external parties without our prior consent. We accept no responsibility to a third party who uses this communication.

Current Developments in the Profession

There have been significant developments in the area of financial reporting, corporate governance and auditing this year.

Auditing and Assurance Standards Board Strategic Plan

The Auditing and Assurance Standards Board (AASB) has adopted International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The ISAs, which deal with the audit of financial statements, will be incorporated into the CICA Handbook and will be called "Canadian Auditing Standards" (CASs). CASs will be applicable to all entities and will be effective for fiscal periods ending on or after December 14, 2010, and will impact our audit of your entity. Below are some of the key changes that will have the most significant impact:

CAS 320 - Materiality and CAS 450 - Evaluation of Misstatements

CAS 320 introduces "performance materiality" to the audit. As you are aware, overall materiality in an audit is used as a guide for planning the nature and extent of audit procedures and for assessing the sufficiency of audit evidence gathered. It is also used in evaluating the misstatements found and determining the appropriate audit opinion to express. Performance materiality will be at 50% to 75% of overall materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. This will have an impact on the amount of work we perform, as the extent of our substantive procedures will be based on performance materiality.

CAS 450 requires that we request correction of all non-trivial misstatements. We will need to obtain from you and document reasons why corrections are not made, and consider these misstatements when determining whether the financial statements are materially misstated. This will help you to maintain accurate accounting books and records and reduce the risk of material misstatements in future periods due to the cumulative affect on uncorrected misstatements related to prior periods.

CAS 560 - Subsequent Events

This standard requires that the date of our auditor's report is the date which the financial statements have been prepared and those with recognized authority have asserted that they have taken responsibility for those financial statements. This means when, for example, management or those charged with governance have approved the draft financial statements.

This will have an impact on procedures that are linked to the date of our auditor's report such as the following:

- legal enquiry letter: we will likely have to send a letter during field work and perform a follow up with legal counsel once our report date is known.
- subsequent event work: we will likely have to send staff to finish off procedures relating to subsequent events while financial statements are being presented for approval if our staff have left your premises prior to the date of the report.

CAS 700 - The Auditor's Report

In addition to there being more flexibility in giving opinions on different bases of accounting, there has been a change in the length and structure of the standard audit report.

Gone is the premise that Canadian generally accepted accounting principles (GAAP) is the only accounting framework acceptable for audit. Soon the premise will be that entity chooses the accounting framework and as long as the framework selected is suitable for the circumstances it can be audited.

Organizations should keep in mind they may have legislative or other requirements to observe which indicate the accounting framework they should follow. In addition organizations should be aware that not every accounting framework is suitable for every circumstance. We can discuss options available to you.

The base wording of the auditor's report will have four paragraphs:

1. The 'Report on the Financial Statements' paragraph describes what we are auditing.
2. The 'Management's Responsibility for the Financial Statements' indicates management is responsible for the preparation of the financial's. It also indicates the framework in use.
3. The 'Auditor's Responsibility' paragraph explains our relationship to the financial's and what an audit entails.
4. The 'Opinion' paragraph contains our conclusions.

If you have any questions on these new audit standards, we would be pleased to discuss them with you in more detail.

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 Finance & Administration Committee, at least annually, all relationships between BDO Canada LLP (and its related entities) and the Town of The Blue Mountains (and its related entities), that, in our professional judgment, may reasonably be thought to bear on our independence for the audit of the organization.

We are aware of the following relationship between the organization and us that, in our professional judgment, may reasonably be thought to bear on our independence. The following relationships represent matters that have occurred:

- We provided assistance in the preparation of the financial statements, including adjusting journal entries and/or bookkeeping services. These services created a self-review threat to our independence since we subsequently expressed an opinion on whether the financial statements presented fairly, in all material respects, the financial position, results of operations and cash flows of the organization in accordance with Canadian generally accepted accounting principles.
- We, therefore, required that the following safeguards be put in place related to the above:
 - Management created the source data for all the accounting entries.
 - Management reviewed and approved all journal entries prepared by us, as well as changes to financial statement presentation and disclosure.
 - Someone other than the preparer reviewed the proposed journal entries and financial statements.

GAAS requires that we confirm our independence to the Finance & Administration Committee in the context of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario. Accordingly, we hereby confirm that we were independent with respect to the Town of The Blue Mountains within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of January 25, 2011.

Responsibilities of the Auditor

It is important for the Finance & Administration 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 is obtained through tests of controls to support the assessment, but the scope of the auditor's review of internal control is insufficient to express an opinion as to the effectiveness or efficiency of the entity's controls; and
 - We expressed an opinion as to whether the consolidated financial statements presented 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 were engaged to perform the audit of the consolidated financial statements of the Town of The Blue Mountains for the year ended December 31, 2009. We adopted an audit approach that allowed 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.

The following sections provide more detail on our audit approach for the Town of The Blue Mountains for the year.

Audit Scope

The scope of our audit of the consolidated financial statements of the Town of The Blue Mountains for the year ended December 31, 2009 included the following:

- An audit opinion on the consolidated municipality
- An audit opinion on the Trust Funds
- An audit opinion on the Library Board
- Auditors' Comments on Supplementary Financial Information for the Museum
- Preparation of the Ontario Financial Information Return

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 used a substantive approach.

Materiality

Materiality can be defined as follows:

"A misstatement or the aggregate of all misstatements in financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities (the user), would be changed or influenced by such misstatement or the aggregate of all misstatements. Misstatements in financial statements arise from departures from generally accepted accounting principles and include departures from fact, inappropriate determination of accounting estimates, and omissions of necessary information. Misstatements may arise from error or fraud, or from the consequences of an illegal act." (CICA Handbook S.5142, AuG-41)

Materiality in an audit is used as a guide for planning the nature and extent of audit procedures and for assessing the sufficiency of audit evidence gathered. It is also used in evaluating the misstatements found and determining the appropriate audit opinion to express.

Although we are required to determine materiality based on our perception of the needs of users, it is extremely difficult to predict with certainty who those users will be or, indeed, the specific needs of known users. Consequently, the materiality decision ultimately becomes a matter for the auditor's professional judgment. We have identified Finance & Administration Committee, ratepayers and long-term debt holders as the most important users of the organization's financial statements.

Canadian generally accepted auditing standards require the use of both quantitative and qualitative factors in determining materiality. For the audit of the Town of The Blue Mountains for the year ended December 31, 2009, we have concluded that a materiality level of \$250,000, based on 1% of normalized expenditures, and adjusted by qualitative factors such as knowledge of your municipality, is appropriate for the purposes of the audit.

Audit Findings

There are a number of matters that arose during the audit that we would like to bring to your attention, although none of them resulted in a qualified opinion. Each of these matters is summarized briefly below. We would be happy to discuss any of these items in more detail at our upcoming meeting.

Likely Aggregate Misstatements

Uncorrected misstatements aggregated during the audit that were determined by management to be immaterial amounted to \$108,041. A summary of the statement of likely aggregate misstatements is attached to this letter.

After considering both quantitative and qualitative factors with respect to the likely aggregate misstatements attached, we agree with management that the financial statements are not materially misstated.

Tax Arrears

An analysis of your tax arrears as at December 31, 2009 is as follows:

	<u>2009</u>	<u>2008</u>
Current year	\$ 2,741,183	\$ 2,978,135
One year	914,148	630,750
Two years	331,828	264,453
Three or more years	223,358	102,457
Interest and penalties	424,695	289,408
	<u>4,635,212</u>	<u>4,265,203</u>
Less: Allowance for uncollectable amounts	(34,000)	(34,000)
	<u>\$ 4,601,212</u>	<u>\$ 4,231,203</u>

Tax arrears as a percentage of the total levy for the year is 15.2% compared to a corresponding percentage of 14.7% at the end of 2008. Current year collections as a percentage of current taxation is 90.9%.

Accumulated Surplus

As shown in the notes to the financial statements your accumulated surplus is comprised of the following:

	<u>2009</u>	<u>2008</u>
Invested in tangible capital assets		
Tangible capital assets at cost less amortization	\$ 158,866,399	152,018,325
Unfinanced capital assets	(6,817,211)	(3,715,508)
Capital assets financed by long-term liabilities and to be funded in future years	(4,715,165)	(5,422,701)
Total invested in capital assets	<u>147,334,023</u>	<u>142,880,116</u>
Unfunded post-employment benefits	(89,819)	(87,331)
Unfunded projects	(156,881)	(82,287)
Unfunded solid waste closure and post-closure costs	(1,142,130)	(1,049,746)
General surplus	1,077,692	577,692
Building inspection deficit	(639,469)	(313,993)
Cemeteries	(113,609)	(36,516)
Recreation, community centres and arenas	67,593	84,018
	<u>146,337,400</u>	<u>141,971,953</u>
Reserves and reserve funds	24,232,686	23,342,630
Accumulated surplus	<u>\$ 170,570,086</u>	<u>\$ 165,314,583</u>

Included in the accumulated surplus above is a deficit in the building inspection department of \$639,469. There have been deficits in this department for two years. Activities within this department should be reviewed to ensure that this deficit does not continue to grow.

Sewer operations had a deficit for the current year of \$3,021 and water operations had a deficit of \$13,844. These amounts should be recovered from sewer and water users in 2010.

Reserves and Reserve Funds

An analysis of your reserves at December 31, 2009 is as follows:

	<u>2009</u>	<u>2008</u>
Reserves		
Working funds	\$ 3,122,532	\$ 2,510,214
Contingencies	-	155,626
Insurance, sick leave and WSIB	162,674	176,927
Current purposes	898,395	840,096
Capital purposes	5,038,723	6,966,895
	<u>\$ 9,222,324</u>	<u>\$ 10,649,758</u>

An analysis of your reserve funds at December 31, 2009 is as follows:

	<u>2009</u>	<u>2008</u>
Obligatory Reserve Funds		
Development charges	\$ 752,376	\$ 1,504,169
Recreational land	619,340	691,392
Federal Gas tax	239,406	227,479
Parking	27,000	27,000
	<u>1,638,122</u>	<u>2,450,040</u>
Discretionary Reserve Funds		
Sewage	11,146,123	9,449,646
Water	2,746,006	2,252,165
General government	22,334	22,180
Roads	734,129	584,692
Garbage and recycling	65,128	64,681
Parks and recreation	199,382	217,682
Library	81,654	86,327
Other	15,606	15,499
	<u>15,010,362</u>	<u>12,692,872</u>
	<u>\$ 16,648,484</u>	<u>\$ 15,142,912</u>

Reserves are amounts set aside for specific purposes to ensure the resources to meet the purpose intended are available when required. We understand that part of Council's budgeting process is a review of the reserves. We recommend Council continue to review annually the reserve balances to determine whether amendments or additions are required and whether reserves in certain areas are adequate. The level of reserves and annual contributions required should correspond to the capital requirements outlined in your comprehensive long-term capital plan.

There are many obligatory reserve funds which are in a negative position. This means that the Town has spent more than what has been raised and the Town is borrowing from other reserve funds to finance capital. The negative reserve funds are; general government \$724,538, fire and rescue \$422,304, roads and related service area \$2,009,378, Craigleith sewer capacity \$1,003,525, Clarksburg Sewer \$367,214, Thornbury East water \$104,004, Thornbury West water \$229,583, Thornbury West sewer \$695,085, Thornbury East sewer \$81,262, and Lora Bay sewers \$1,158,380. Council should ensure that these reserve fund deficits are addressed in the next development charge summary and reduce capital spending where appropriate.

Internal Controls

We obtained a sufficient understanding of internal controls to enable us to plan the audit. In certain areas we assessed control risk below the maximum and obtained sufficient appropriate evidence through tests of control to support that assessment, however, our study and evaluation of internal controls was not sufficient to express an opinion on the effectiveness of the organization's internal control systems.

Review of Internal Controls

Our review of internal controls is undertaken to identify key controls which we rely on to provide some of the audit evidence to support our audit opinion. It is management's role to implement effective controls to protect the assets of the municipality and to ensure accurate financial reporting. It is the role of Council through the Finance & Administration Committee to ensure that management has effective internal controls in place. We recommend that management document all systems and test the controls on a regular basis and report their findings to the Finance & Administration Committee. These reviews will help improve the safeguarding of assets and accumulate reliable financial reporting.

Review of Internal Financial Statements

Our responsibility as auditors is to express an opinion on the financial statements based on an audit which includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Management is responsible for the preparation of the financial statements and reporting to Council. We recommend that Council approve final financial statements prior to the commencement of our audit. There should be few, if any, journal entries required after the financial statements have been approved. This would ensure Council is receiving reliable information and ensure a more efficient audit.

Accounting for Capital Transactions

The financial statements for 2009 are the first set of statements for the Town of the Blue Mountains under the new presentation standards including tangible capital assets. A significant amount of work was completed to accumulate and report on this information. The following are some suggested improvements that could be made in relation to the reporting of tangible capital assets.

Amortization of Capital

Currently amortization is being reported as a general government expense and is not allocated appropriately across the functional areas. We would suggest that amortization be allocated to allow for more reasonable comparisons of actual results to budgeted results on the financial statements. The allocation of amortization must also be completed for FIR purposes.

Capitalization of Interest

Under the current capital asset policy interest is not capitalized as part of the capital asset cost. Interest is being calculated and applied to capital projects and then being reallocated to operating expenses once the tangible capital asset entries are finalized. In essence, on a consolidated basis, the current operations are recognizing interest revenue and the related interest expense at the same time. We would suggest that if interest is not capitalized then interest not be allocated to capital projects.

Unfunded Operating Projects

There were projects in the old capital fund, which upon adoption of the new accounting standards, did not meet the criteria of a capital asset. These projects were reallocated and moved into the current operations. We have shown these as unfunded projects in the accumulated surplus. We would suggest that these amounts be reviewed and funded accordingly.

Management Representations

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

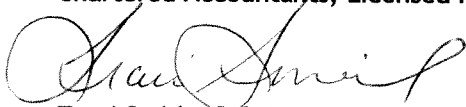
Management's representations included, but were not limited to:

- matters communicated in discussions with us, whether solicited or unsolicited;
- matters communicated electronically to us;
- schedules, analyses and reports prepared by the organization, and management's notations and comments thereon, whether or not in response to a request by us;
- internal and external memoranda or correspondence;
- minutes of meetings of the Council and Committees;
- approval of the financial statements; and
- a representation letter from management.

We wish to express our appreciation for the co-operation we received during the audit from the organization's management. We would be pleased to discuss with you any matters mentioned in this letter, as well as any other matters that may be of interest to you.

Yours truly,

BDO Canada LLP
Chartered Accountants, Licensed Public Accountants



Traci Smith, C.G.A.

TS:nb

Town of The Blue Mountains
Summary of Unadjusted Misstatements

December 31, 2009

Description of the Misstatement	Identified Misstatement	Projected Misstatement	Estimates	Proposed Adjustments			
				Assets Dr(Cr)	Liabilities Dr(Cr)	Opening Fund Dr(Cr)	Income Dr(Cr)
Allowance for Doubtful Accounts difference	50,689	-	-	(50,689)	-	-	50,689
Understated accrual for Harbour Lease	12,130	-	-	-	(12,130)	-	12,130
Understated accrual for audit fees assuming TCA has not been considered.	-	-	20,000	-	(20,000)	-	20,000
Estimate of liability for PEB	-	-	34,836	-	(34,836)	-	34,836
Estimate of liability for retirement benefit	-	-	10,853	-	(10,853)	-	10,853
Overstated of prepaid/overstated liabilities for Great West Life	35,627	-	-	(35,627)	35,627	-	-
A/R error	2,935	-	-	2,935	-	-	(2,935)
Likely Aggregate Misstatements Before Effect of Previous Year's Errors and Estimates	101,381	-	65,689	(83,381)	(42,192)	-	125,573
Effect of Previous Year's Errors				-	-	17,532	(17,532)
Likely Aggregate Misstatements				(83,381)	(42,192)	17,532	108,041