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**Private & Confidential**

April 21, 2011

The Town of the Blue Mountains  
32 Mill Street  
Box 310  
Thornbury, Ontario  
N0H 2P0

Dear Sir/Madam:

**Re: Audit of the Consolidated Financial Statements of The Town of the Blue Mountains  
For the year ended December 31, 2010**

The purpose of this report is to communicate to the Council certain aspects of the audit that we believe would be of interest to you. The Council 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 Council 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.

**Independence**

At the core of the provision of external audit services is the concept of independence. We are communicating matters that, in our professional judgment, may reasonably be thought to bear on our independence for the forthcoming audit of the municipality.

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

We hereby confirm that we are 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 April 21, 2011.

**Responsibilities of the Auditor**

It is important for the Council to understand the responsibilities that rest with the municipality and its management and those that belong to the auditor. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities outlined below:

- 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) assessing the risks of material misstatement of the financial statements, whether due to fraud or error;
  - (ii) 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;
  - (iii) examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
  - (iv) assessing the accounting principles used and their application; and
  - (v) 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.
- 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.

Further details regarding our responsibilities are outlined in our engagement letter.

### Audit Approach

We have been engaged to perform the audit of the consolidated financial statements of The Town of the Blue Mountains for the year ended December 31, 2010. We will adopt an audit approach that allows us to issue an audit opinion on the consolidated financial statements of the municipality in the most cost effective manner, while still obtaining the assurance necessary to support our audit opinion.

Under the BDO Audit Approach, we use risk and assurance models to determine the evidence to collect and evaluate whether sufficient appropriate evidence was obtained to be able to draw reasonable conclusions to allow us to form an opinion. 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 municipality'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 municipality 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.

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

### ***Audit Scope***

We anticipate the scope of our audit of the consolidated financial statements of The Town of the Blue Mountains for the year ended December 31, 2010 to include the following:

- An audit opinion on the consolidated entity
- Preparation of the 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 municipality 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 municipality and a preliminary review of your internal controls, we anticipate using a combined 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."*

Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole 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.

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

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 Council as the most important users of the municipality'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, 2010, we have concluded that a materiality level of \$600,000, based on 2% of revenues, and adjusted by qualitative factors such as experience of staff and adjustments required in previous years, is appropriate for the purposes of planning the audit.

### **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:

- matters communicated in discussions with us, whether solicited or unsolicited;
- matters communicated electronically to us;
- 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;
- internal and external memoranda or correspondence;
- minutes of meetings of the board of directors or similar bodies such as audit committees and compensation committees; and
- a representation letter from management.

### **Communication of Results**

At the completion of our audit, just prior to issuing our Auditor's 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 Council 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 municipality's financial reporting;
- whether or not there were significant difficulties encountered during the audit;
- significant matters discussed, or those subject to correspondence with management;
- other matters arising from the audit that, in our professional judgment, are important and relevant to the Council; and
- matters previously agreed with you to be communicated to the Council.

**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 Council.

Yours truly,

BDO Canada LLP  
Chartered Accountants, Licensed Public Accountants



Traci Smith, C.G.A.

TS:nb