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AUDIT

McMaster Students Union Incorporated

Audit Findings Report
For the year ended April 30, 2015

KPMG LLP

kpmg.ca

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At KPMG, we are **passionate** about earning your **trust**. We take deep **personal accountability**, individually and as a team, to deliver **exceptional service and value** in all our dealings with you.

At the end of the day, we measure our success from the **only perspective that matters – yours**.

Executive summary

Purpose of this report*

The purpose of this Audit Findings Report is to assist you, as a member of the Board of Directors, in your review of the results of our audit of the financial statements of McMaster Students Union Incorporated as at and for the year ended April 30, 2015.

Audit plan

Materiality was assessed as follows:

Based on total audited revenues from 2014 based at 3% for a total materiality amount of $381,000

Areas of Audit Focus

We have highlighted our findings related to key areas of audit focus. We have highlighted key audit findings and procedures in our report.

See page 5

Adjustments and differences

We did not identify any differences that remain uncorrected. See *page 7* for a listing of adjustments that were communicated to management and subsequently corrected in the financial statements as part of the audit process.

Finalizing the audit

As of the date of this report, we have completed the audit of the financial statements, with the exception of certain remaining procedures, which include amongst others:

- receipt of signed management representation letter;
- completing our discussions with the Board of Directors; and
- obtaining evidence of the Student Representative Assembly's approval of the financial statements.

We will update the Board 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.

***** This Audit Findings Report should not be used for any other purpose or by anyone other than the Board of Directors. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this Audit Findings Report has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Executive summary

Control and other observations

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

Critical accounting estimates

Overall, we are satisfied with the reasonability of critical accounting estimates.

The critical areas of estimates relate to: deferral of student health and dental plan revenues at year end.

See page 5

Significant accounting policies and practices

There have been no initial selections of, or changes to, significant accounting policies and practices to bring to your attention.

Independence

We confirm that we are independent with respect to McMaster Students Union Incorporated (and its related entities) within the meaning of the relevant rules are related interpretations prescribed by the relevant professional bodies in Canada and any applicable legislation or regulation from May 1, 2014 up to the date of our auditors' report.

Areas of audit focus

Inherent risk of material misstatement is the susceptibility of a balance or assertion to misstatement which could be material, individually or when aggregated with other misstatements, assuming that there are no related controls.

We highlight our significant findings in respect of significant financial reporting risks as identified in our discussion with you in the Audit Plan, as well as any additional significant risks identified.

Significant financial statement caption	Our significant findings from the audit
Investments	During fiscal 2015, MSU no longer carries investments with TD Waterhouse, rather these investments have been transferred to Scotia McLeod and Dundee Goodman In the current year, the portfolio earned $495,000 of investment income compared to $216,000 in the prior year. KPMG has confirmed all balances with Scotia McLeod and Dundee Goodman, no issues were noted in the reconciliation process
Inventory	KPMG attended an inventory count at Union Market and noted that the inventory count was effective based on our testing. No issues or concerns were identified as part of this inventory count. These count results are a significant improvement over the 2014 inventory count which required recounts.
Student Health and Dental Plans	The corporate fiscal year runs from May 1st to April 30th, while the school year and student coverage runs from September 1st to August 31st. This means that as at April 30th, there is still 4 months of the school year left. This timing issue results in a required deferral of revenues on student fees collected in these areas. The MSU has recorded deferred revenue amounts related to the fees received from McMaster University for both plans in relation to expected future payment of the claims and premiums to the end of the school year. Deferred revenue for the health and dental plans are $425,000 and $835,000, respectively. The Health Plan ended the year with a surplus of approximately $192,000 and the Dental Plan ended the year with a surplus of $48,000. KPMG reviewed the calculation of the deferred revenue and agreed with the calculations performed by management. No adjustments were required to reported balances.

Areas of audit focus

Significant financial statement caption	Our significant findings from the audit
Child Care Centre	KPMG performed an audit over MSU's Child care expenses as required by the agreement with the City of Hamilton. The Special Purpose Wage Subsidy Report for year ended April 30, 2015 will be provided to the City of Hamilton. No issues or variances were identified in our testing. The Child Care Centre operations ended the 2014/15 fiscal year with a deficit of $31,500 compared with a deficit of $25,000 in the prior year. Revenues remained consistent with 2014/15, however the Centre had an increase in expenses, mostly within wages, which has contributed to the larger deficit in the current year.
Intercompany Transactions	Consistent with prior years, it was found that separate departments within the MSU infrastructure are charging revenues and recording expenses for transactions between departments of the MSU. As the MSU is a single legal entity, any intercompany revenues and expenses should be eliminated on consolidation of the financial activity of the organization. KPMG noted that starting in 2015, management has included adjustments to account for the elimination of charges between the departments. Due to reconciliation procedures involved this was only done for 2015 and was not retroactively adjusted to 2014. KPMG is satisfied with this approach as the adjustments reflect the elimination of the inter division charges that require elimination for the consolidated financial statements.
Marmor revenues	During testing of the Marmor revenues, KPMG noted that an accrual related to repairs for the 2009-10 Marmor existed. After review and discussion with management it was determined that the Marmor would not be fully reprinted for errors and only done on an ad hoc basis. Given limited requests for reprints exist, the full accrual for reprinting of the full 2009-10 Marmor is not required. KPMG proposed an adjustment to reverse this accrual and this amount is reflected as other recoveries in the Marmor revenue and expenditures schedule. This has been corrected by management in the current year financial statements.

Adjustments and differences

Adjustments and differences identified during the audit have been categorized as Corrected "adjustments" or Uncorrected "differences." These include disclosure adjustments and differences.

Professional standards require that we request of management and the audit committee that all identified adjustments or differences be corrected. We have already made this request of management.

Corrected adjustments

The management representation letter includes all adjustments identified as a result of the audit, communicated to management and subsequently corrected in the financial statements.

Uncorrected differences

We did not identify differences that remain uncorrected.

Adjustments and differences

Based on both qualitative and quantitative considerations, management have decided not to correct certain differences and represented to us that the differences—individually and in the aggregate—are, in their judgment, not material to the financial statements.

As at and year ended April 30, 2015

	Income effect	Financial position		
		Assets	Liabilities	Equity
Description of differences greater than $19,000 individually	**(Decrease) Increase**	**(Decrease) Increase**	**(Decrease) Increase**	**(Decrease) Increase**
To reverse Marmor accrual for 09-10 reprints	$ 65,000	-	$ (65,000)	-
To record an adjustment to occupancy costs from MUCI (reconciliation of related party amounts)	13,605	-	(13,605)	-
To reconcile with McMaster University	144,224	144,224	-	-
Total differences	$ 222,829	$144,224	$ (78,605)	-

We concur with management's representation that the differences are not material to the financial statements. Accordingly, the differences have no effect on our auditors' report.

Implications of adjustments and differences

Although the differences have no effect on our auditors' report, these differences or the underlying matters regarding differences and adjustments (e.g., control deficiencies) could potentially cause future annual or interim financial statements to be materially misstated or have an implication on the financial reporting process.

The implications of such misstatements on the MSU's internal control over financial reporting (ICFR) are discussed in "Control Observations."

Control observations

In accordance with professional standards, we are required to communicate to the Audit Committee any control deficiencies that we identified during the audit and have determined to be significant deficiencies in ICFR.

Other control deficiencies may be identified during the audit that do not rise to the level of significant deficiency.

Significant deficiencies

We did not identify any significant control deficiencies

Other control deficiencies

We did not identify any other control deficiencies

Appendices

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:

- **Auditors' report** – the conclusion of our audit is set out in our draft auditors' report as attached
- **Management representation letter** –In accordance with professional standards, copies of the management representation letter are provided to the Board of Directors.
- **Independence** – In accordance with professional standards, we have confirmed our independence to the Organization and no issues concerning independence are noted for discussion with the committee.
- **CPAB all firm inspection report (March 2015)** – Please refer to http://www.cpab-ccrc.ca/Documents/Topics/Public%20Reports/2014_Public_Report_EN.pdf

Appendix 2: 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 http://www.kpmg.com/Ca/en/services/Audit/Pages/Audit-Quality-Resources.aspx for more information.

- 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 3: Background and professional standards

Internal control over financial reporting

As your auditors, we are required to obtain an understanding of internal control over financial reporting (ICFR) relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on internal control. Accordingly, we do not express an opinion on the effectiveness of internal control.

Our understanding of ICFR was for the limited purpose described above and was not designed to identify all control deficiencies that might be significant deficiencies and therefore, there can be no assurance that all significant deficiencies and other control deficiencies have been identified. Our awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

The control deficiencies communicated to you are limited to those control deficiencies that we identified during the audit.

Documents containing or referring to the audited financial statements

We are required by our professional standards to read only documents containing or referring to audited financial statements and our related auditors' report that are available through to the date of our auditors' report. The objective of reading these documents through to the date of our auditors' report is to identify material inconsistencies, if any, between the audited financial statements and the other information. We also have certain responsibilities, if on reading the other information for the purpose of identifying material inconsistencies, we become aware of an apparent material misstatement of fact.

We are also required by our professional standards when the financial statements are translated into another language to consider whether each version, available through to the date of our auditors' report, contains the same information and carries the same meaning.

Appendix 4: Current developments

Current Developments, created by the KPMG Public Sector and Not-for-Profit Practice, summarizes regulatory and governance matters impacting not-for-profit organizations. We provide this information to help not-for-profit organizations understand upcoming changes and challenges they may face in their industry. We attach this summary to every audit plan and audit findings report that we provide to our public sector clients

Standard	Summary and implications
Canada Revenue Agency Non-Profit Organization Risk Identification Project	The Canadian Revenue Agency (CRA) has completed its Non-Profit Organization Risk Identification Project (the NPORIP) on non-profit organizations which claim the exemption from income tax under Paragraph 149(1)(l) of the Income Tax Act of Canada. The objective of the NPORIP was to gather information about the not-for-profit sector, including the revenue-generating activities of NPOs, the amount of surpluses accumulated and an assessment of the "tax at risk" in the NPO sector. The Project consisted of CRA conducting audits of the tax-exempt status of 1,437 non-profit organizations (out of approximately 30,000 NPOs who file a tax or information return) over a three-year period ending in 2013. In February 2014, the CRA issued its final report on the results of the NPORIP. The full report can be found on CRA's website at www.cra-arc.gc.ca/tx/nnprft/nprft-prjct-rprt-eng.html. Below, we quote the summary from the CRA report: Summary *"The NPORIP was designed to provide the CRA with insight into the way certain organizations—those seeking an exemption from tax under paragraph 149(1)(l) of the Act—operate under the income tax rules. The NPORIP has given the CRA a better understanding of the issues these organizations face in complying with the Act, and, in particular, has highlighted a number of areas where the non-profit sector's understanding of the law differs from that of the CRA. In addition, the NPORIP has revealed a significant issue with compliance by these organizations in several key areas.* *The results from the review of the randomly-selected organizations suggest that a significant portion of incorporated organizations would fail to meet at least one of the requirements set out in paragraph 149(1)(l) of the Act. Of these:* • *A significant portion would fall into a higher category of risk, which includes organizations earning profits that were not incidental or not related to their non-profit objectives; organizations with disproportionately large reserves, surpluses, or retained earnings; and organizations where income is payable or made available for the personal benefit of a proprietor, member, or shareholder. Many of the organizations that fall within this higher risk category would not actually qualify for the tax exemption under paragraph 149(1)(l) of the Act and would need to be reassessed if they were audited outside the purview of the NPORIP, which would in most cases result in an increased tax liability to the organization.* • *A small portion would fall into a lower category of risk, which includes readily correctable issues, such as making filing errors or not providing enough information to substantiate a not-for-profit purpose in the organization's governing documents* Based on its review, the CRA recognizes that education and outreach with the non-profit sector are critical to improving many organizations' compliance with paragraph 149(1)(l) of the Act. Accordingly, it will work with representatives of the non-profit sector to determine how the sector's knowledge of the income tax rules can be improved. The CRA will also look to improve NPOs' understanding of their income tax obligations through targeted outreach activities, client service, and education. As part of this work, the CRA will review, revise, and improve as required the educational materials and support it provides in this regard. Finally, because

	the review also reveals that the legislative framework may benefit from further examination, a copy of this report will be provided to the Department of Finance Canada for information and consideration." In the 2014 Economic Action Plan, the Government announced its intention to proceed with public consultations with non-profit organizations on these issues. It is anticipated that this public consultation process will ultimately result in changes to the Income Tax Act and other legislation and regulations governing the activities of non-profit organizations. The Department of Finance has committed to providing further details on the public consultation process in the coming months. The Department is working on a consultation paper to guide this process. It is anticipated that the public consultation process will not begin until late 2015. KPMG is monitoring this situation closely and will update our clients as we learn more about the public consultation process. KPMG encourages the Boards and management of NPOs, and of charities, to continue to prepare their organizations for the anticipated changes to legislation and regulations. Non-profit organizations should consider the three main risk areas identified by CRA in the NPORIP: 1. having individual activities not related to their non-profit objectives; or earning non-incidental profits from individual activities 2. using income to provide personal benefits to members 3. maintaining excessive accumulated reserves, surpluses or net assets Organizations should review and consider their non-profit objectives, strategic plans, risk assessments, financial results and operational practices in the context of the aforementioned risk areas identified by CRA. Non-profit organizations should develop and maintain on-going, consistent empirical evidence on how their activities support their non-profit objectives, and the need and purpose of their net assets. Board oversight throughout this process will be a crucial element to its success. Most importantly, management and Board members of non-profit organizations should monitor, and participate in, the upcoming public consultations with the Government.
GST/HST Harmonized Audits	The Canada Revenue Agency (CRA) has followed through on its intent to focus on public service bodies (e.g., municipalities, universities, colleges, hospitals, schools, associations, charities, non-profits etc.) for purposes of conducting GST/HST audits. Many public service bodies have undergone audits or have been contacted to begin an audit. We offer the following general observations on the impact of the CRA's increased focus on the public sector: • It is important that you have a plan in place for a GST/HST audit, including having a fixed point of contact for the auditor. Planning and managing the audit is as important as having the appropriate policies and procedures. • The CRA has been focusing on documentation, sharing arrangements, grants and sponsorships, and the allocation of inputs between taxable and exempt activities for input tax credit purposes (e.g. the filing of a Section 211 election and claiming of input tax credits on the use of real property). • The CRA has not consistently been applying audit offsets (e.g., allowing unclaimed input tax credits or rebates) that would help minimize the impact of any assessments Our experience with GST/HST auditors has varied from audit to audit. However, in each case, the taxpayer has the burden of proof. The best approach is to be prepared in advance of receiving that call from CRA.

Cyber Security - It's more than just Technology	Organizations are subject to increasing amounts of legislative and public pressures to show they are managing and protecting their information appropriately. Simultaneously, the threats from cyber criminals and hackivists are growing in scale and sophistication. Organizations are also increasingly vulnerable as a result of technological advances and changing working practices including remote access, cloud computing, mobile technology and services on demand. The financial and reputational costs of not being prepared against a cyber-attack could be significant. Cyber Security is not solely about Information Technology; it is fundamentally an operational and governance issue. Not-for- profit organizations should develop an operations-wide understanding of their threats, safeguards, and responses. Preparing this summary diagnostic will require the involvement of individuals in all areas of the organization, including those involved in hiring, procurement, customer relations and management. Key elements to consider include: • Assessing the likelihood and intensity of a cyber-attack, based on the value of your information and your public profile • Assessing your vulnerabilities to a cyber-attack • Preparing your people, processes, infrastructure and technology to resist a cyber-attack, and to minimize its impact • Detecting a cyber-attack and initiating your response • Containing and investigating the cyber-attack • Recovering from a cyber-attack and resuming business operations • Reporting on and improving security Not-for-profit organizations are at particular risk due to the information they maintain, including research data, member or student data, and health information. The reputational risk of this information not being adequately protected can often outweigh the financial consequences of a breach. Not-for-profit organizations need to review their operations and consider cyber risks, then assess the organization's cyber maturity in addressing those risks. Structured models for completing this exercise exist for organizations of all sizes, as no one is immune to the risk of a cyber-attack. KPMG in Canada, in collaboration with Imagine Canada, recently presented a webinar called "*Cyber Security: The new threat for Not-for-Profit Organizations*". We encourage you to view this webinar on Imagine Canada's website at: http://sectorsource.ca/resource/video/cyber-security-not-profit-organizations-presented-kpmg

New Guidance on Internal Controls and Management Practices

Not-for-profit organizations and charities are facing significant pressures to become more efficient and effective in the delivery of their services and in the management of their operations. In addition, stakeholders are demanding greater transparency and accountability from charitable and not-for-profit organizations on their stewardship of resources, achievement of their objectives, and ability to demonstrate value-for-money. This environment has placed higher expectations and increased responsibilities on Board Members to provide appropriate diligence and oversight of the operations, risks, management, controls and governance of their organizations.

One of the ways that Boards and Audit Committees demonstrate appropriate diligence and oversight is to compare their organization's operations and management practices against a recognized Framework that is generally accepted by its stakeholders, including members, funders and regulators. In 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) updated its Internal Control – Integrated Framework, which is the most widely used and recognized Framework in North America. The updated Framework provides all not-for-profit and charitable organizations with an excellent basis for an assessment of their operations and management practices.

The COSO Framework highlights general management processes for an effective and efficient control environment. The Framework provides a recognized baseline against which existing management practices can be assessed to help ensure that the organization's efforts are focused on areas of highest value and significance to the organization's objectives and stakeholders. A comparison of current practice to the Framework will provide Board members with information on their organization's efficiency, effectiveness, transparency and accountability, and identify potential improvements that are relevant and applicable in the not-for-profit and charity environment.