

Financial Statements

City of Toronto Sinking Funds

December 31, 2010

Independent Auditor's Report

To the Chair and Members
of the City of Toronto Sinking Funds Committee,

We have audited the accompanying financial statements of the City of Toronto Sinking Funds, which comprise the balance sheet as at December 31, 2010 and the statements of operations and changes in unrestricted surplus, and cash flows for the year then ended, and the related notes including a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the City of Toronto Sinking Funds as at December 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Other matter

The financial statements as at December 31, 2009 and for the year then ended were audited by another auditor who expressed an unmodified opinion on those financial statements on April 12, 2010.

Chartered Accountants, Licensed Public Accountants

July 5, 2011

Toronto, Canada

City of Toronto Sinking Funds

BALANCE SHEET

As at December 31, 2010

	2010	2009
	\$	\$
	[in thousands]	
ASSETS		
Current		
Cash	7,231	1,600
Other Receivables	5,290	-
Investments, at market value <i>[note 3]</i>	1,692,325	1,131,441
	1,704,846	1,133,041
LIABILITIES AND NET ASSETS		
Current		
Accounts payable and accrued liabilities	29	20
Distributions payable <i>[note 4]</i>	12,864	3,401
Total current liabilities	12,893	3,421
Actuarial requirements <i>[note 5]</i>	1,070,154	1,041,715
Total liabilities	1,083,047	1,045,136
Net assets		
Unrestricted surplus <i>[note 4]</i>	109,657	87,905
Internally restricted surplus <i>[note 4]</i>	512,142	-
Total surplus	621,799	87,905
	1,704,846	1,133,041

See accompanying notes

City of Toronto Sinking Funds

STATEMENT OF OPERATIONS AND CHANGES
IN UNRESTRICTED SURPLUS

Year ended December 31, 2010

	2010	2009
	\$	\$
	[in thousands]	
REVENUES		
Contributions	749,800	209,523
Investment income	81,996	43,465
	831,796	252,988
EXPENSES		
Provision for actuarial requirements <i>[note 5]</i>	288,439	249,661
Excess of revenues of expenses for the year	543,357	3,327
Unrestricted surplus, beginning of year	87,905	87,979
Distribution of surplus contributions <i>[note 4]</i>	(9,463)	(3,401)
Unrestricted surplus, beginning of year	78,442	84,578
Total surplus, end of year	621,799	87,905

See accompanying notes

City of Toronto Sinking Funds

STATEMENT OF CASH FLOWS

Year ended December 31, 2010

	2010 \$	2009 \$
	[in thousands]	
OPERATING ACTIVITIES		
Excess of revenues over expenses for the year	543,357	3,327
Add (deduct) items not involving cash		
Amortized discount on investments	(22,952)	(24,209)
Accrued interest	(150)	(1,204)
Unrealized gain (loss) on investments	(27,691)	1,326
	492,564	(20,760)
Changes in non-cash working capital balances related to operations		
Accounts payable and accrued liabilities	9	5
Other receivables	(5,290)	-
Cash used in operating activities	487,283	(20,755)
INVESTING ACTIVITIES		
Purchase of investments	(7,475,729)	(1,793,729)
Proceeds from maturities of investments	6,863,969	1,469,821
Proceeds from sale of investments	101,669	92,373
Cash used in investing activities	(510,091)	(231,535)
FINANCING ACTIVITIES		
Increase in sinking fund requirements	288,439	249,661
Maturity of debenture	(260,000)	-
Cash provided by financing activities	28,439	249,661
Net increase (decrease) in cash during the year	5,631	(2,629)
Cash, beginning of year	1,600	4,229
Cash, end of year	7,231	1,600

See accompanying notes

**SCHEDULE OF PROJECTION OF
DEBENTURE MATURITIES**

Year ended December 31, 2010

The following is a list of the projected maturities of the sinking fund debentures, held within the City of Toronto:

	\$
	[in thousands]
2011	200,000
2013	120,000
2014	228,000
2015	300,000
2016	475,000
2017	500,000
2018	425,000
2019	400,000
2021	150,000
2040	600,000
	<u>3,398,000</u>

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NOTES TO FINANCIAL STATEMENTS

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1. PURPOSE OF FUNDS

The City of Toronto Sinking Funds [the “Sinking Funds”] accumulates amounts through periodic contributions from contributors, which are calculated such that the contributions and interest earnings will be sufficient to retire the principal amount of the sinking fund debt (*Schedule*) when it matures. When the accumulated sinking fund exceeds the par value of the related debenture, the excess may be refunded or applied against other sinking fund accounts of the same contributor(s).

The City of Toronto Sinking Fund is governed under the *City of Toronto Act, 1997 (No. 2) Statutes of Ontario, 1997, Chapter 26* and is exempt from income taxes under section 149(1) of the Canada Income Tax Act.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian public sector accounting standards. They are the representation of management and necessarily involve the use of best estimates and careful judgement. The significant accounting policies are summarized below:

Revenue recognition

Contributions are recognized as revenue in the year receivable. Interest income is recorded when earned.

Financial instruments

Financial assets include cash and investments. The value of investments recorded in the financial statements is valued based on the latest bid prices. The Fund's investment activities expose it to a range of financial risks, including market risk, credit risk, and, liquidity risk. The Fund manages these risks utilizing a balanced approach of investments through debentures issued or guaranteed by provincial and municipal governments and by corporate

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bonds. The Fund does not invest in equity or foreign investments, thus reducing market risks. The Fund's investment in fixed income securities is exposed to credit risk, the maximum risk exposure being the cost of these investments. Liquidity risk is managed by ensuring the Fund invests in high quality investments easily disposed of in an active market.

Transactions are recorded on a settlement-date basis. Transaction costs are expensed as incurred.

While investments are purchased with the intention of holding them until maturity, for accounting purposes investments have been designated as held for trading because investments may be sold to redeem the debentures if certain debentures provide for early redemption and market conditions are favourable. Investments may also be sold to acquire securities with a better rate of return.

Sinking Funds debenture issues are grouped by sinking fund interest rates. These rates represent the investment earnings assumptions for each of the respective funds and are used in determining the annual contributions required to retire the outstanding debt.

Investment income includes interest and realized and unrealized gains and losses and is included in the statement of operations and changes in unrestricted surplus.

Financial liabilities are presented at amortized cost, which approximates fair value.

Management estimates and sinking fund requirements

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and surplus at the reporting date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The area where the most judgement is applied is with respect to the actuarial requirements of the Sinking Funds. The provision for actuarial requirements of the sinking fund for the year represents the amounts levied during the year as set out in the sinking fund debenture bylaws

plus interest accrued thereon compounded at the sinking fund rate of 6% per annum on debt issued from 1993 to 1996 and 4% or 5% per annum on debt issued in 1997 and thereafter. The sinking fund requirements are expected to accumulate to an amount sufficient to pay the **City of Toronto Sinking Funds**

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related debentures upon maturity. The excess of revenue over these requirements for the year is included in the fund balance.

3. INVESTMENTS

Investments consist of the following:

	Market value	Par value
	\$	\$
	[in thousands]	
2010		
Debentures issued or guaranteed by:		
Provincial governments	951,855	1,218,930
City of Toronto	151,172	138,574
Other Canadian municipalities	127,178	114,965
Corporate debt	462,120	452,096
Total	1,692,325	1,924,565
2009		
Debentures issued or guaranteed by:		
Provincial governments	696,242	901,201
City of Toronto	121,437	123,593
Other Canadian municipalities	43,360	38,987
Corporate debt	270,402	260,187
Total	1,131,441	1,323,968

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	2010 \$	2009 \$
	[in thousands]	
Amortized cost	1,608,751	1,075,708
Weighted average yield	4.00%	5.46%
Average term to maturity	6.08 years	5.89 years
Excess of market value over amortized cost	83,575	55,733

4. NET ASSETS

Total surplus consists of the following:

	2010 \$	2009 \$
	[in thousands]	
City of Toronto unrestricted surplus	30,099	35,930
Toronto District School Board	1,296	1,404
Total unrestricted surplus based on amortized cost	31,395	37,334
Unrealized gain on investments	78,262	50,571
Internally restricted surplus	512,142	-
Total net assets	1,704,846	87,905

Included in total net assets, and part of the unrestricted surplus shown on the statement of operations and changes in unrestricted surplus, are surplus funds of \$5,845 [2009-\$9,463] that were available to be distributed as a result of the maturity of two debt issues in 2010 [2009-one debt issue]. The distribution of these funds to the City of Toronto and to the Toronto District School Board is subject to approval by the City of Toronto Sinking Funds Committee and the City of Toronto Council.

In March 2010, the City of Toronto Sinking Funds Committee approved the distribution of the 2008 surplus amount of \$9,463, which was approved by the City of Toronto Council in June 2010. These distributions were not paid and, accordingly, were recorded as distributions payable as at December 31, 2010.

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In December 2008, the City of Toronto Sinking Funds Committee approved the distribution of the 2007 surplus amount of \$3,401, which was approved by the City of Toronto Council in April 2009. These distributions were not paid and, accordingly, were recorded as distributions payable as at December 31, 2010.

In 2010, the City received proceeds of \$528 million from the sale of the Toronto Hydro note receivable including a gain on sale of \$37.885 million. The City of Toronto Council directed these proceeds to be deposited into the Strategic Infrastructure Partnership Reserve Fund. Subsequently Council approved the transfer of \$600 million from the Strategic Infrastructure Partnership Reserve Fund to the City's Sinking Funds to prepay a portion of the Sinking Fund debentures' future liabilities. The transfer resulted in an internally restricted surplus which will be reduced over time to meet the future actuarial requirements to retire those debenture issues.

5. SINKING FUND REQUIREMENTS

The change in the sinking fund requirements for the year is as follows:

	2010	2009
	\$	\$
	[in thousands]	
Sinking fund requirements, beginning of year	1,041,715	792,054
Add provision for sinking fund requirements	288,439	249,661
	1,330,154	1,041,715
Less par value of debentures matured during the year	260,000	-
Sinking fund requirements, end of year	1,070,154	1,041,715

6. CAPITAL MANAGEMENT

In managing capital, the Sinking Funds focus on liquid resources available for reinvestment. The Sinking Funds objective is to have sufficient liquid resources to meet its debenture obligations when they mature, despite adverse financial events. The need for sufficient liquid

resources is considered in the investment process. As at December 31, 2010, the Sinking Funds has met its objective of having sufficient liquid resources to meet its current obligations.