TORONTO TRANSIT COMMISSION
REPORT NO. 3(b)

MEETING DATE: May 24, 2013

SUBJECT: DRAFT CONSOLIDATED FINANCIAL STATEMENTS OF TORONTO TRANSIT COMMISSION FOR THE YEAR ENDED DECEMBER 31, 2012

ACTION ITEM

RECOMMENDATION

It is recommended that the Board:

1) Approve the draft consolidated financial statements of the Toronto Transit Commission for the year ended December 31, 2012; and

2) Forward a copy of the approved consolidated financial statements to City Council for information through the Audit Committee of the City of Toronto,

BACKGROUND

The Board's Audit Committee reviewed the consolidated financial statements of the TTC at its meeting on April 25, 2013. After due consideration and discussion with the auditors, PricewaterhouseCoopers LLP, the Audit Committee approved the submission of the consolidated financial statements for the year ended December 31, 2012 to a regular Board meeting for approval.

DISCUSSION

The draft consolidated financial statements of the Toronto Transit Commission for the year ended December 31, 2012 have been prepared by management. They have been audited by PricewaterhouseCoopers LLP ("PWC"), as indicated by the Auditor's Report (or 'Opinion') included with the attached statements. The Auditor's Report provides an opinion that the consolidated financial statements present fairly, in all material respects, the financial position of the Commission in accordance with Canadian Public Sector Accounting Standards (PSAS).

Key Components of the Consolidated Financial Statements

The attached consolidated financial statements consist of four main statements and 17 notes that provide context to the numbers that are presented on the statements. The four statements presented are:

1) **Consolidated Statement of Financial Position**
The Consolidated Statement of Financial Position is considered to be the equivalent of the private sector's balance sheet. This statement focuses on the Commission's assets (financial and non-financial) and liabilities. The difference between the liabilities and financial assets is the Commission's net debt, which represents the net amount that will be funded from future revenue.

2) **Consolidated Statement of Operations and Accumulated Surplus**
The Consolidated Statement of Operations and Accumulated Surplus is considered to be the equivalent of the private sector's Statement of Income and Retained Earnings. It provides a summary of the revenues and expenses for the year.

3) **Consolidated Statement of Change in Net Debt**
This statement outlines the items that have caused a change to the net debt amount that is presented on the Consolidated Statement of Financial Position.

4) **Consolidated Statement of Cash Flows**
This statement outlines the key cash inflows and outflows to explain the change in the cash balance on a year over year basis.

Operating Budgets Surplus for the Year

It is important to note that the accounting surplus presented on the consolidated financial statements is unrelated to the 2012 operating budgets surplus. The Commission had an operating budget surplus of $41.0M for conventional transit and $1.7M for Wheel-Trans. This surplus represented the amount by which the operating subsidy available from the City of Toronto exceeded the amount that was actually required and used by the Commission. The operating budget surplus is summarized as follows:

$ millions	TTC Conventional Transit	Wheel-Trans	Total
2012 Operating Revenue	1,087.2	5.6	1,092.8
2012 Operating Expenses[1]	1,457.2	100.7	1,557.9
Current Operating Subsidy Required	370.0	95.1	465.1
Current Operating Surplus Available	411.0	96.8	507.8
Operating Budget Surplus	**$41.0**	**$1.7**	**$42.7**

[1] When compared to the amount reported on the Consolidated Statement of Operations, this amount excludes: depreciation related to subsidized capital assets; TTC Pension Fund expenses in excess of required contributions; environmental expenses funded through capital subsidy; and the costs of certain employee post-retirement benefits and accident claims that are funded through the long-term receivable but includes the City's Special Costs (details can be found on the Consolidated Financial Statements Schedule at the end of the Financial Statements).

The budget for operating subsidy on the consolidated statement of operations is $533M and the actual operating subsidy recognized is $480.6M. The difference between these amounts and the information presented in the table above relate to the portion of environmental expenses funded through capital subsidy as well as accident claims and employee benefits that are funded through the long-term receivable. These expenses were $9.7M under budget.

Accounting Surplus – As Reported in the Consolidated Financial Statements

The accounting surplus for the year as reported in the Consolidated Statement of Operations is comprised of the following items:

Item	Amount
Capital subsidy revenue	1,216.0M
Depreciation expense for assets that were funded through capital subsidy	(262.0M)
Pension Fund Society expense in excess of required contributions	(84.9M)
Entities under the control of TTC	(0.4M)
Other expenses funded through capital subsidy	(3.2M)
Total	**865.5M**

Explanations for the components of the accounting surplus are as follows:

Capital Subsidy Revenue and Depreciation Expense: $954.0M (net)
Capital subsidies are used to acquire or construct capital assets. Under PSAS, these subsidies must be recognized as revenue, in the year that the Commission qualified for the funding (i.e. the year in which the capital asset was acquired or constructed). In 2012, the Commission recognized $1,216.0M in capital subsidy revenue.

The cost of these capital assets, however, is not immediately recorded as an expense as the assets will serve the Commission for several years. Instead, a depreciation expense is recorded in the Consolidated Statement of Operations over several years as the assets are used and gradually wear out. In 2012, the Commission recorded $262.0M of depreciation expense which is an estimate of the decline in value of Commission's assets in 2012 due to age and use.

The difference between the capital subsidy revenue ($1,216.0M) noted above and the depreciation expense for subsidized assets ($262.0M), is the source of $954.0M of the accounting surplus, however this amount does not represent surplus funds. The full $1,216.0M was spent on the capital assets acquired or constructed this year.

Typically, operating budget reports do not include the capital subsidy revenue or the depreciation expense for the related assets because these subsidies are incorporated into the capital budget process and because depreciation expense is an accounting expense that is not linked to any cash requirement.

Pension Fund Society Expense in Excess of Required Contributions: ($84.9M)
The Commission is required to make contributions to the TTC Pension Fund Society, as set by the TTC Pension Fund Board, subject to the funding requirements determined in the actuarial report and subject to the limitations of the Sponsorship Agreement. PSAS requires the Commission to account for the TTC Pension Fund in a manner similar to a defined benefit plan. This accounting change resulted in $84.9M of accounting expense being included in the Commission's financial statements in 2012, even though the cash contributions percentage required remained unchanged.

Entities Under the Control of TTC: ($0.4M) (net deficit)
Budgets and periodic financial reports are presented separately for the TTC conventional transit system, Wheel-Trans operations, Toronto Coach Terminal Inc., TTC Insurance Company Ltd. and the TTC Sick Benefit Association. However PSAS requires these financial statements to be presented on a consolidated (i.e. combined) basis. Therefore the results for all entities controlled by the Commission are reported in aggregate. As a result, the $487K deficit reported by the Toronto Coach Terminal Inc. and the $1K surplus reported by the Toronto Transit Infrastructure Limited are reported in these consolidated financial statements and form part of the Commission's consolidated surplus for the year.

Other Expenses Funded Through Capital Subsidy: ($3.2M)
The Conventional Transit Service expenses include $3.2M of environmental expenses that were funded through the capital subsidy noted above.

The above information provides some context to the amount presented in the attached consolidated financial statements. Both staff and PWC auditors would be pleased to answer any further questions that you may have about the financial statements for 2012.

Following the Commission's approval of these statements, two Commissioners will sign off on the consolidated statement of financial position.

In accordance with the City of Toronto Act, 2006, the Commission's consolidated financial statements should be routed to City Council, through the City's Audit Committee.

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Attachment: Draft 2012 Consolidated Toronto Transit Commission Financial Statements

Consolidated Financial Statements of

TORONTO TRANSIT COMMISSION

Year ended December 31, 2012

pwc

June 14, 2013

Independent Auditor's Report

**To the Members of the Board of
the Toronto Transit Commission**

We have audited the accompanying consolidated financial statements of Toronto Transit Commission, which comprise the consolidated statement of financial position as at December 31, 2012 and the consolidated statements of operations and accumulated surplus, net debt and cash flows for the year then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

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Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Toronto Transit Commission as at December 31, 2012 and the results of its operations, its net debt and cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Other matter
The accompanying consolidated financial statements supplementary schedules as at and for the year ended December 31, 2012 is presented as supplementary information only and is not a required part of the basic consolidated financial statements. The information in these schedules has been subject to audit procedures only to the extent necessary to express an opinion on the consolidated financial statements of the Toronto Transit Commission.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

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Consolidated Statement of Financial Position
As at

	December 31, 2012 ($000s)	December 31, 2011 ($000s)
Financial Assets		
Cash and Cash Equivalents (Note 3)	104,271	60,375
Subsidies Receivable (Note 4)	795,351	711,372
Accounts Receivable	84,084	74,692
Portfolio Investments (Note 5)	2,541	2,547
Total Financial Assets	**986,247**	**848,986**
Liabilities		
Accounts Payable and Accrued Liabilities	512,013	438,817
Deferred Passenger Revenue	77,000	76,150
Unsettled Accident Claims (Note 6)	169,821	157,833
Future Employee Benefits (Note 7)	448,066	399,911
Environmental liabilities (Note 8)	15,275	13,400
Total Liabilities	**1,222,175**	**1,086,111**
Net Debt	**(235,928)**	**(237,125)**
Non-Financial Assets		
Tangible Capital Assets (Note 9)	6,460,217	5,515,064
Spare Parts and Supplies Inventory	107,803	101,605
Prepaid Expense	2,821	5,021
Accrued Pension Benefit Asset (Note 7)	-	84,884
Total Non-Financial Assets	**6,570,841**	**5,706,574**
Accumulated Surplus (Note 10)	**6,334,913**	**5,469,449**

See accompanying notes to the consolidated financial statements

Approved: Karen Stintz
Commissioner

Commissioner

Consolidated Statement of Operations and Accumulated Surplus
For the year ended December 31

	2012 Budget ($000s) (Note 14)	2012 ($000s)	2011 ($000s)
Operating Revenue			
Passenger Services	1,008,924	1,023,423	976,015
Advertising	25,250	26,097	15,815
Outside City Services	18,784	17,722	17,813
Property Rental	21,677	20,512	19,339
Miscellaneous	6,239	7,758	7,700
Total Operating Revenue	**1,080,874**	**1,095,512**	**1,036,682**
Subsidy Revenue			
Operating Subsidies (Note 11)	532,965	480,571	523,436
Capital Subsidies (Note 12)	1,765,240	1,216,022	918,484
Total Subsidy Revenue	**2,298,205**	**1,696,593**	**1,441,920**
Total Revenue	**3,379,079**	**2,792,105**	**2,478,602**
EXPENSES			
Conventional Transit Service	1,841,713	1,811,854	1,663,268
Wheel-Trans	113,638	111,524	103,411
Other Functions	4,715	3,263	4,817
Total Expenses (Note 13)	**1,960,066**	**1,926,641**	**1,771,496**
Surplus for the year	**1,419,013**	**865,464**	**707,106**
Accumulated surplus, beginning of the year		5,469,449	4,762,343
Accumulated surplus, end of the year		**6,334,913**	**5,469,449**

See accompanying notes to the consolidated financial statements

Consolidated Statement of Net Debt
For the year ended December 31

	2012 Budget ($000s)	2012 Actual ($000s)	2011 Actual ($000s)
Surplus for the year	1,419,013	865,464	707,106
Change in capital assets			
Acquisitions	(1,786,652)	(1,234,362)	(937,945)
Amortization	289,662	289,159	312,265
Loss (Gain) on disposal	-	(1,907)	6,935
Proceeds on sale	-	1,957	485
Total Change in Capital Assets	(1,496,990)	(945,153)	(618,260)
Change in Pension Benefit Asset	84,884	84,884	(84,884)
Change in Spare Parts and Supplies	-	(6,198)	(5,537)
Change in Prepaid Expenses	-	2,200	(3,165)
Change in Net Debt	6,907	1,197	(4,740)
Net Debt, beginning of year	(228,623)	(237,125)	(232,385)
Net Debt, end of year	**(221,716)**	**(235,928)**	**(237,125)**

Consolidated Statement of Cash Flows
For the year ended December 31

	2012	2011
	($000s)	($000s)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from passenger services	1,024,273	988,313
Operating subsidies received	450,089	450,211
Non-passenger revenue received	73,355	63,338
Cash paid for wages, salaries and benefits	(1,110,197)	(1,088,200)
Cash paid to suppliers	(296,461)	(348,618)
Cash paid for accident claims	(24,578)	(34,445)
Cash provided by operating activities	116,481	30,599
CASH FLOWS FROM CAPITAL ACTIVITIES		
Capital asset acquisitions	(1,138,528)	(785,844)
Capital subsidies received	1,065,943	749,384
Cash (used in) capital activities	(36,460)	(36,460)
Increase (decrease) in cash and cash equivalents during the year	43,896	(5,861)
Cash and cash equivalents, beginning of the year	60,375	66,236
Cash and cash equivalents, end of the year	104,271	60,375

See accompanying notes to the consolidated financial statements

Notes to the Consolidated Financial Statements

for the Year Ended December 31, 2012

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1. NATURE OF OPERATIONS

The Toronto Transit Commission (the "TTC" or the "Commission") was established on January 1, 1954 to consolidate and co-ordinate all forms of local transportation within the City of Toronto (the "City"), except railways and taxis. As confirmed in the City of Toronto Act (2006), the Commission shall plan for the future development of local passenger transportation so as to best serve its inhabitants and the City, and City Council is not entitled to exercise a power related to local transportation, except as it relates to the Toronto Islands. However, from a funding perspective, the Commission functions as one of the agencies, boards, and commissions of the City and is dependent upon the City for both operating and capital subsidies (notes 11 and 12). The Commission also operates Wheel-Trans, a transit service for people with disabilities, which is also subsidized by the City. The Commission's subsidiaries include the Toronto Transit Infrastructure Limited, Toronto Coach Terminal Inc. and its subsidiary, the TTC Insurance Company Limited. Since the TTC Sick Benefit Association is controlled by the Commission, its results are also consolidated. The Commission, which is not subject to income and capital taxes, receives an 11.24% rebate for the Harmonized Sales Tax, and receives exemption from certain property taxes.

2. SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation

These consolidated financial statements are prepared by the TTC in accordance with the standards applicable for other government organizations found in the Canadian Institute of Chartered Accountants ("CICA") Public Sector Accounting Handbook.

b. Basis of consolidation

The consolidated financial statements include the operations of Wheel-Trans and the financial results of the Commission's subsidiaries, Toronto Transit Infrastructure Limited ("TTIL") and Toronto Coach Terminal Inc. ("TCTI") and TCTI's subsidiary, TTC Insurance Company Limited (the "Insurance Co."). The results of the TTC Sick Benefit Association ("SBA"), which is controlled by the Commission, have also been consolidated.

c. Measurement uncertainty

The preparation of the consolidated financial statements in conformity with public sector accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Specifically, future employee benefits and the accrued pension benefit asset are subject to the assumptions described in note 7 and other contingencies are described in note 16a. Depreciation expense is based on the asset lives described in note 2h and accident claims liabilities are subject to assumptions on discount rates and amounts reserved for incurred but not reported claims as described in note 6. Deferred revenue is based on estimated value of fare media sold, but not yet used before year end. Actual results could differ from the amounts estimated.

d. Subsidy Revenue

Operating subsidies are authorized by the City after the Commission's operating budget has been approved. Operating subsidy revenue is recognized by the Commission in the period to the extent that net operating costs are incurred. Capital subsidies are recognized in revenue when the City authorizes the capital subsidy and the eligibility criteria and related stipulations have been met.

e. Operating Revenue and Deferred Passenger Revenue

Revenue is recognized when cash, tickets and tokens are used by the passenger to secure a ride. An estimate of tickets and tokens sold, which will be used after the year end, is included in deferred passenger revenue. Revenue from passes is recognized in the period in which the passes are valid. An estimated value of passes sold, but only valid after year end, is included in deferred passenger revenue. Other revenue is recognized when the services have been provided.

f. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and money market instruments, such as bankers' acceptances, which have original maturities at acquisition of three months or less and are readily convertible to cash on short notice.

g. Spare parts and supplies inventory

Spare parts are valued at weighted-average cost, net of allowance for obsolete and excess parts.

h. Tangible Capital assets and depreciation

Tangible capital assets are recorded at cost less accumulated depreciation. In addition to direct costs attributable to capital projects, the Commission capitalizes certain internal costs which are directly related to the acquisition, construction, betterment, or development of those related capital assets. Depreciation is calculated using the straight-line method, based on the estimated useful lives of major assets, as follows:

Asset	Years
Subways	20-65
Buildings & Structures	20-40
Rolling Stock	6-30
Buses	6-18
Trackwork	15-30
Other Equipment	4-26
Traction Power Distribution System	24-25

Capital assets are amortized from the date that they enter service. One-half year of the depreciation expense is recorded in the year of acquisition and assets under construction are not depreciated until the asset is substantially complete and available for productive use. Land purchased directly by the City, for the Commission's use, is accounted for in the City's records.

i. Portfolio investments

Portfolio investments consist of bonds that are recorded at cost. Discounts or premiums on investments are amortized on a straight-line basis until maturity of the investment to which this item is related. Investment income is reported as revenue in the period earned.

j. Unsettled accident claims

The Commission has a self-insurance program for automobile and general liability claims. Estimated costs to settle automobile and general liability claims are actuarially determined, based on available loss information and projections of the present value of estimated future expenditures developed from the Commission's historical experience. The provision for estimated future expenditures includes expected internal and external adjustment expenses, an estimate of claims incurred but not reported and a provision for adverse deviations.

k. Employee future benefit plans

The Commission's employee benefits plans include both post-employment plans (workplace safety and insurance benefit plan and long term disability benefit plan), post-retirement plans (medical and dental benefits) and pension plans.

The costs of the post-employment benefit plans are recognized when the event that obligates the Commission occurs. Costs include projected future income replacement payments, health care continuation costs, taxes and fees paid to independent administrators, calculated on a present value basis.

The costs and obligations of the post-retirement benefit plans and pension plans are calculated using the projected benefits prorated on service method and management's best estimates of retirement ages of employees, future salary levels, expected health care cost escalations, and plan investment performance.

The net asset or liability related to each employee future benefit plan reflects the year-end difference between the value of the accrued benefit obligation and the value of the plan assets (if funded), net of unamortized gains and losses and the valuation allowance. Plan assets are valued using year-end fair market values.

Accrued benefit obligations and costs are determined using discount rates that are consistent with the City's long-term borrowing rates for the post-employment and post-retirement plans. For the Commission's funded pension plans, the discount rate is the plan's expected rate of return on plan assets.

Actuarial gains and losses arise from changes in actuarial assumptions or when actual experience differs from what was assumed. For post-employment benefit plans, the net actuarial gain or loss is deferred and amortized on a straight-line basis over the average expected period during which benefits will be paid unless there is a related plan amendment or curtailment. For workplace safety insurance benefits, the amortization period is 10 years (December 31, 2011 – 10 years) and for long-term disability benefits, the amortization period is 12.25 years (December 31, 2011 – 9.93 years). The amortization of the gain/loss begins in the year after the actuarial gain/loss arises.

A post-retirement benefit plan actuarial gain or loss is deferred and amortized over the expected average remaining service life of the employees unless there is a plan amendment or curtailment. The amortization period for the pension plan, post-retirement medical and post-retirement dental plans, varies from 10.9 to 12.1 years (December 31, 2011 – 11.7 to 12.7 years) and for the supplemental funded pension plan, the amortization period is 3 years (December 31, 2011 – 3 years). The amortization of the actuarial gain or loss begins in the year after the gain or loss arises for all post-retirement plans except the TTC pension plan. Amortization begins in the year of the actuarial gain or loss for the TTC pension plan. This policy is expected to reduce the long term expense volatility that results from the accounting requirement to defer and amortize actuarial losses.

Past service costs arising from a plan amendment or plan initiation are recognized in the period of a plan amendment. Prior service costs or gains are offset by net actuarial gains or losses, if any, as of the end of the calendar year in which the prior service costs or gains arise. Unamortized amounts that remain after offsetting with prior period service costs or gains continue to be amortized in their original amount. Also, unamortized actuarial gains or losses related to settled or curtailed plans are recognized in the period of the plan settlement or curtailment.

l. Environmental provision

Those conditions that have been clearly identified as being in non-compliance with environmental legislation and with costs that can be reasonably determined have been accrued. The estimated amounts of future remediation costs are reviewed regularly, based on available information and governing legislation.

3. CASH AND CASH EQUIVALENTS

In connection with the City guarantee referred to in note 6, the TTC Insurance Company Limited, is required to maintain cash or securities available for payment of accident claims liabilities equal to one month's claims and operating expenses (all self-insured retention payments are processed through the TTC). The cash and cash equivalents amount restricted for this purpose is $3.0 million as at December 31, 2012 (December 31, 2011 - $3.0 million).

4. SUBSIDIES RECEIVABLE

Subsidies from the City of Toronto consist of operating subsidies as described in note 11 and capital subsidies as described in note 12. Subsidies receivable as at December 31 comprise the following amounts, all of which are due from the City of Toronto:

	2012	2011
		($000s)
Subsidies to be collected within one year		
Capital Subsidy Receivable	356,241	332,302
Operating Subsidy Receivable	116,329	104,830
Total subsidies to be collected within one year	**472,570**	**437,132**
Other recoverable amounts		
Employee Benefits	183,994	159,618
Accident Claims Expenses	57,742	63,135
Construction Holdbacks	67,170	39,487
Future Environmental Costs (note 8)	13,875	12,000
Total Other Recoverable amounts	**322,781**	**274,240**
Total Subsidies Receivable	**795,351**	**711,372**

The Commission expects to collect the capital and operating subsidy receivable within one year.

The amount related to non-cash employee benefits and accident claim expenses represents the delayed payment of operating subsidy for the non-cash portion of these expenses.

Subsidy related to construction holdbacks will be collected in the year that the holdback is released to the vendor. Subsidy for future environmental costs will be collected in the year in which the related work is performed.

5. PORTFOLIO INVESTMENTS

Portfolio investments as at December 31 consist of two bonds, as follows:

	2012	**2011**
		($000s)
Bank of Nova Scotia Notes (2.25%; May 8, 2015 maturity)	1,995	-
City of Toronto bond (8.65%; June 8, 2015 maturity)	546	546
Province of Ontario bond (5.375%; December 2, 2012 maturity)	-	2,001
Total portfolio investments	**2,541**	**2,547**

At December 31, 2012, the fair value of the bonds is $2.6 million (December 31, 2011 - $2.7 million).

6. UNSETTLED ACCIDENT CLAIMS

The TTC Insurance Company Limited ("Insurance Co.") was established in 1994 in order to provide insurance coverage for compulsory automobile personal injury and accident benefit claims for the Commission. At December 31, 2012, $154.7 million (December 31, 2011 - $144.8 million) of the unsettled accident claims liability is related to the Insurance Co.'s payable for all automobile claims incurred. This portion of the Commission's accident claim liability is guaranteed by the City. The Commission has purchased insurance from third-party insurers to cover tort claims in excess of $5 million on any one accident. The remainder of the unsettled accident claims liability, $15.1 million, (December 31, 2011 - $13.0 million) relates to general liability claims, net of expected HST rebates.

The ultimate cost of these liabilities will vary from the best estimate made by management for a variety of reasons, including additional information with respect to the facts and circumstances of the claims incurred. The liability includes a reserve established for each file as well as an incurred but not reported ("IBNR") provision to account for the fact that full information on case files may not be available at the valuation date, or losses have been incurred but are not yet reported. Therefore, the Commission relies upon historical information and statistical models, to estimate the IBNR liability. The Commission also uses reported claims trends, claims severity, exposure growth and other factors in estimating its IBNR reserve. The time required to learn of and settle claims is an important consideration in establishing the Commission's reserves. The Commission revises these reserves as additional information becomes available.

This provision is discounted to take into account the time value of money and a provision for adverse deviation ["PFAD"] is added, as recommended by standard actuarial practice. Assumptions regarding the anticipated timing of future payments and an appropriate discount rate are made by management. As uncertainty exists with respect to the determination of these discounted estimates, an explicit PFAD is made for potential claims development. A PFAD is selected based on guidance developed by the Canadian Institute of Actuaries.

The following table summarizes the effects of the time value of money and PFAD on the liability for unpaid claims and claims adjustment costs.

Unpaid claims and claims adjustment costs:	Undiscounted	Time Value of Money	PFAD	Discounted
				($000s)
As at December 31, 2012	164,358	(9,870)	15,333	169,821
As at December 31, 2011	149,649	(6,205)	14,389	157,833

As at December 31, 2012, the interest rate used to determine the time value of money was 1.95% and reflected the market yield (December 31, 2011 – 1.35%).