

TORONTO TRANSIT COMMISSION REPORT NO. 1(a)

MEETING DATE: May 24, 2013

SUBJECT: PRICEWATERHOUSECOOPERS LLP AUDIT RESULTS
REPORT ON THE TORONTO TRANSIT COMMISSION
CONSOLIDATED FINANCIAL STATEMENTS FOR THE
YEAR ENDED DECEMBER 31, 2012

ACTION ITEM

REASON FOR CONFIDENTIAL INFORMATION:

This report contains information which is subject to solicitor-client privilege.

RECOMMENDATION

It is recommended that the Board:

- 1) Receive the attached report from PricewaterhouseCoopers LLP ("PWC"), including the information noted in the confidential attachment, regarding the audit of the consolidated financial statements of the Toronto Transit Commission for the year ended December 31, 2012, for information;
- 2) Forward a copy of the attached report to City Council through the Audit Committee of the City of Toronto; and
- 3) Retain the contents of the Confidential Attachment confidential in their entirety as it contains advice which is subject to solicitor-client privilege.

BACKGROUND

At the Audit Committee meeting on April 25, 2013, a review was undertaken of the attached report from the external auditors, regarding the audit of the consolidated financial statements of the Toronto Transit Commission for the year ended December 31, 2012.

DISCUSSION

The 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 PWC, in accordance with the plan presented to the Audit Committee on February 19, 2013. The attached report from PWC provides comments on significant audit, accounting and financial reporting matters which are summarized on pages 4 through 6.

A summary of unadjusted misstatements is shown on page 7 of the attached report. The summary of unadjusted misstatements is a normal component of an audit report. If the total of all differences is below the audit materiality level (\$20 million), the auditors do not require a change to the financial statements, which is the case for 2012.

Pages 27 to 35 of the attached report contain the management letter on internal control recommendations. A management letter provides recommendations for the improvement of internal controls and accounting procedures. Staff welcome these suggestions as they strive to improve their procedures on a continuing basis. Management's initial response to these recommendations is included in the attachment. A follow-up report on these recommendations will be presented to the Audit Committee later this year.

Both staff and PWC would be pleased to answer any questions that you may have about the report and the audit in general.

42-22

Attachment: PWC LLP Yearend Report to the Audit Committee

Toronto Transit Commission

*2012 Year-end report
to the Audit Committee*

*Prepared as of April
15, 2013*





June 14, 2013

Members of the Audit Committee of the
Toronto Transit Commission

Dear Members of the Audit Committee:

Further to our Year-End Audit Committee report, dated April 15, 2013 which was presented to the Audit Committee of the Toronto Transit Commission on April 25, 2013, we have provided below an update on the Status of the Audit section of our report (page 4) and also have included an updated summary of unadjusted misstatements which was included in Appendix B of our report dated April 15, 2012.

We would also like to update you on our final materiality levels used throughout the conduct of our audits. Preliminary materiality levels were previously reported to you in the 2012 audit plan dated January 16, 2013. Overall materiality for the financial statements was determined to be:

- Consolidated Toronto Transit Commission- \$20 million
- Consolidated Toronto Coach Terminal Inc. - \$3.18 million (specific materiality over stand-alone operations of \$75,180)
- Toronto Transit Commission Insurance Company - \$3.09 million

Status of the Audits

As of the date of this letter we have completed all of our previously reported outstanding items and we are in a position to issue our audit report on the consolidated financial statements as at December 31, 2012 and for the year then ended.

Yours very truly,

PricewaterhouseCoopers LLP

Cathy Russell
Partner
Audit and Assurance Group

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PwC refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



Appendix B: Summary of unadjusted misstatements

The first two adjustments below were previously noted in our year-end audit committee report dated April 15, 2013. Adjustment 3 below was added subsequent to the Audit Committee meeting held on April 25, 2013.

Description (presented in thousands)	Surplus Over/ (Under) Stated	Financial Assets (Over)/ Under Stated	Liabilities Over/ (Under) Stated	Non- Financial Assets (Over)/ Under Stated	Opening Accumulated Surplus Over/ (Under) Stated
Current year unadjusted misstatements:					
Understatement of accounts payable and cash The TTC incorrectly understated accounts payable and cash, by not reversing a cancelled check relating to a payable for 2012 in the amount of \$1.2 million. Dr. Cash & Cash equivalents Cr. Accounts Payable & Accruals	-	1,159	(1,159)	-	-
Overstatement of gain on sale The TTC incorrectly overstated the gain on sale of subway cars by not writing off the remaining net book value of the H6 subway cars sold. Dr. Miscellaneous operating revenue Cr. Tangible Capital Assets	1,495	-	-	(1,495)	-
Potential understatement of accounts payable and fixed assets Unreconciled difference between TTC and City of Toronto on the amounts owing to the City of Toronto. Dr. Tangible Capital Assets Cr. Accounts Payable			(2,056)	2,056	
Total unadjusted misstatements	1,495	1,159	(3,215)	561	-



April 15, 2013

Members of the Audit Committee
Toronto Transit Commission

Dear Members of the Audit Committee:

We have substantially completed our audit of the consolidated financial statements of the Toronto Transit Commission (the TTC) prepared in accordance with Canadian Public Sector Accounting Standards for the year ended December 31, 2012. We propose to issue an unqualified report on those financial statements, pending resolution of outstanding items outlined on page 1. Our draft auditor's report is included as Appendix A.

We have issued the accompanying report to assist you in your review of the financial statements. It includes an update on the status of our work, as well as a discussion on the significant accounting and financial reporting issues dealt with during the audit process.

We propose to review the key elements of this report at the upcoming meeting and discuss with you our key findings.

We would like to express our sincere thanks to the management and staff of the TTC who have assisted us in carrying out our audit work and we look forward to our meeting on April 25, 2013. Should you have any questions or concerns prior to the Audit Committee meeting, please do not hesitate to contact me in advance.

Yours very truly,

PricewaterhouseCoopers LLP

Cathy Russell
Partner
Audit and Assurance Group

c.c.: Members of the Audit Committee
Mr. Vincent Rodo, Chief Financial & Administration Officer
Mr. Michael Roche, Head of Finance & Treasurer

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Appendices

Appendix A: Draft auditor's report

Appendix B: Management representation letter

Appendix C: Independence letter

Appendix D: Management Letter

Appendix E: Confidential Appendix

The matters raised in this and other reports that will flow from the audit are only those that have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising and, in particular, we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted, as the report has not been prepared for, and is not intended for, any other purpose. Comments and conclusions should only be taken in context of the financial statements as a whole as we do not mean to express an opinion on any individual item or accounting estimate.

1. *Executive summary*

a. **Status of the audit**

We have substantially completed our audit of the 2012 consolidated financial statements (the financial statements). Our auditor's report will be issued once we receive and have completed our audit work on the outstanding items noted below.

This document includes the required communications between an auditor and Audit Committee, as required by Canadian generally accepted auditing standards (Canadian GAAS).

Our audit has been performed substantially in accordance with the plan and timeline previously communicated.

The following items will need to be completed/received prior to the issuance of our opinion. We will provide a verbal update on the status of these outstanding items at our upcoming meeting.

Outstanding item
i. City of Toronto confirmation of amounts receivable from / payable to the TTC, including support for any reconciling items
ii. Final review of Tangible Capital Asset continuity schedules and support of a sample of capitalized labour.
iii. Finalization of audit work relating to the TTC Pension Fund Society
iv. Final review of management's sensitivity analysis on environmental liabilities
v. Responses to our legal confirmation letters from external legal counsel
vi. Completion of subsequent event procedures to the date of our audit opinion
vii. General queries of management and miscellaneous outstanding information relating to audit work in progress
viii. Receipt of signed management representation letter
ix. Receipt and review of the TTC annual report
x. Approval of the consolidated financial statements by the Audit Committee

b. Key issues for discussion

Discussion item	Summary	For further reference
Significant Accounting Estimates	<ul style="list-style-type: none"> In preparing the consolidated financial statements there were a number of significant accounting estimates that required management judgment. Based on our audit work performed, we have concluded that the significant accounting estimates included in the consolidated financial statements are supportable. 	Page 4
Management Override of Controls	<ul style="list-style-type: none"> In completing our audit, we are responsible for maintaining professional scepticism and considering the potential for management override of controls. Based on our audit work performed, we found no circumstances that evidenced inappropriate management override of controls. 	Page 5
Capital Accounting for Transit Expansion	<ul style="list-style-type: none"> In the current year additional clarification was obtained regarding the Transit Expansion assets and the associated capital subsidy. All capital assets relating to the approved Transit Expansion lines continue to not be included in the consolidated financial statements of the TTC as they are owned by Metrolinx. 	Page 6
Summary of unadjusted items	<ul style="list-style-type: none"> As a result of our audit, we identified two unadjusted misstatements results in the surplus being overstated by \$1.5 million for the year ended December 31, 2012. In our opinion, the financial statements, taken as a whole, are free of material misstatement. 	Page 7
Fraud	<ul style="list-style-type: none"> No instances of fraud were noted as part of our audit procedures. We wish to reconfirm whether the Audit Committee is aware of any known, suspected or alleged incidents of fraud. 	
Control deficiencies	<ul style="list-style-type: none"> No significant deficiencies in internal controls were noted during the course of our audit. We have noted several internal control recommendations which we have brought to the attention of management and the Audit Committee. 	Page 9 and Appendix D
Independence	<ul style="list-style-type: none"> We confirm that we are independent of the TTC as at April 15, 2013, and our independence letter can be found in Appendix C. 	Appendix C

Discussion item	Summary	For further reference
Management representations	<ul style="list-style-type: none">Under Canadian GAAS, we are required to inform you of the representations we are requesting from management. A copy of the management representation letter is included in Appendix B.	Appendix B

2. Significant audit, accounting and financial reporting matters

Preparation of the financial statements requires management to select accounting policies, as well as make critical accounting estimates and disclosures that may involve significant judgment and measurement uncertainty. These matters can significantly impact the company's reported results.

We are responsible for discussing with the Audit Committee our views about the significant qualitative aspects of the company's accounting practices, including accounting policies, the accounting estimates, and financial statement disclosures in accordance with the requirements of Public Sector Accounting Standards (PSAS).

Our comments and views included in this report should only be taken in the context of the financial statements as a whole and are not meant to express an opinion on any individual item or accounting estimate. We are sharing our views with you to facilitate an open dialogue of these matters.

Item 1	Significant Accounting Estimates
<p>Background information and management's process</p>	<ul style="list-style-type: none"> • In preparing the consolidated financial statements there were a number of significant accounting estimates that required management's judgment, including the following: <ul style="list-style-type: none"> ◦ Deferred passenger revenue ◦ TTC Pension Fund and employee future benefits ◦ Unsettled accident claims ◦ Contingent liabilities (provisions for legal claims) • Management has processes and controls in place for formulating these estimates. Where applicable, management has engaged external specialists to assist in the determination of these significant accounting estimates. In particular, the TTC has contracted external specialists to assist with the valuation of the TTC pension fund assets and obligation, employee future benefits and accident claim liabilities.
<p>Subjective estimates / areas of judgment by management</p>	<p>Significant estimates and areas of judgment made by management are as follows:</p> <ul style="list-style-type: none"> • Deferred passenger revenue - Token and ticket loss factors as well as estimating the dollar amount of fare media in the custody of TTC employees and the public at year-end. • TTC Pension Fund and employee future benefits – Discount rates used to present value the pension and employee future benefit (WSIB, LTD, Post retirement and Post employment Health and Dental) obligations are between 3.1% and 5.8%. Numerous other actuarial assumptions such as mortality rates, retirement age etc. are also incorporated in the valuation of these obligations. • Unsettled accident claims – The measurement of the unsettled accident claims liability uses a number of estimates and actuarial assumptions, including a discount rate of 1.95% to present value future settlements. The actuary has incorporated claims provisions for adverse deviations (PFAD) within a reasonable range and has also incorporated an appropriate internal loss adjustment expense.

Item 1 (cont'd)	Significant Accounting Estimates
	<ul style="list-style-type: none"> Contingent liabilities (provisions for legal claims) – The TTC is subject to a number of legal claims, in connection with operations, labour relations and the completion of capital projects. Management uses all information available including the assessment by external counsel of the likelihood of a claim and historical experience to record provisions for what management believes is the most accurate estimate of future settlement based on the current known facts.
PwC's Views	<ul style="list-style-type: none"> Deferred passenger revenue - We met with TTC management to understand the process for establishing deferred revenue. As part of the audit, we tested the key assumptions and concluded that all assumptions used in the calculation were supportable and within our expected range. TTC Pension Fund and employee future benefits – We examined the third party actuarial valuations of the TTC Pension Fund and employee future benefit obligations at year-end with the assistance of our PwC actuarial specialists to assess the appropriateness of the assumptions and methodology used to record the pension and employee future benefit liabilities. No significant matters were noted. Unsettled accident claims – Our PwC actuarial specialists assessed the reasonableness of the assumptions and methodology used by the TTC in recording the unsettled accident claims liability. We tested the accuracy and completeness of the data used in the calculation and our specialists independently projected a reserve estimate which was compared to the estimate recorded by the TTC. No significant differences were noted. Contingent liabilities (provisions for legal claims) - We obtained independent legal confirmations letters from all external counsel to obtain third party confirmation on the status of outstanding legal proceedings and discussed significant cases with the TTC's internal legal counsel and management. We ensured that the provision recorded at year-end is supported and consistent with the conclusions reached within the external confirmations received.
Conclusion	Based on the testing performed above, we conclude that these significant accounting estimates are reasonable and have been recorded in accordance with PSAS.

Item 2	Management Override of Controls
Background information and management's process	<ul style="list-style-type: none"> In completing our audit, we are responsible for maintaining professional scepticism throughout our audit engagement, considering the potential for management override of controls. Management has a process to ensure that appropriate segregation of duties have been established at the TTC in order to mitigate the risk of management override of controls. The TTC has policies in place to prevent and detect fraud, including a code of conduct, an internal audit department and a process to review and approve manual journal entries.
PwC's Views	<ul style="list-style-type: none"> We reviewed the quarterly fraud investigation reports in corroboration with the call log of the City Whistleblower hotline related to TTC events. No pervasive items were noted in this review.

Item 2 (Cont'd)	Management Override of Controls
	<ul style="list-style-type: none"> We performed audit work on a sample of significant and non-standard manual journal entries. We obtained documentation to support the manual entries selected and also confirmed that all were appropriately approved.
PwC's Views	<ul style="list-style-type: none"> Through our audit procedures on manual journal entries we noted certain circumstances where we believe there was inappropriate segregation of duties and accordingly we have raised an internal control recommendation in Appendix D.
Conclusion	<ul style="list-style-type: none"> Based on our work performed, we found no circumstances that evidenced inappropriate management override of controls.

Item 3	Capital Accounting for Transit Expansion
Background information and management's process	<ul style="list-style-type: none"> As reported previously, in fiscal 2011, Metrolinx, the TTC and the City negotiated and made progress towards finalizing a Master Agreement for Transit Expansion. In previous years, property, procurement, financial and communications protocols were drafted and established in principal detailing issues of ownership, contracting, invoicing and liability. During fiscal 2012, assignment and assumption agreements were finalized and signed between Metrolinx and the TTC transferring all rights and obligations to Metrolinx for a variety of the on-going contracts and it was agreed that all Transit Expansion assets would be owned by Metrolinx. Through the current year, additional project funding of \$66.7 million has been drawn from the City to subsidize all 2012 expenditures. At December 31, 2012, total eligible expenditures of \$254.3 million incurred to date on capital assets relating to the approved Transit Expansion lines have not been included in the consolidated financial statements of the TTC.
PwC's Views/Conclusion	<ul style="list-style-type: none"> Excluding Transit Expansion assets from the consolidated financial statements of the TTC is consistent with the Memorandum of Agreement dated November 2009 and the subsequent assignment and assumption agreements executed in fiscal 2012. It should be noted that the TTC has numerous future purchase commitments with third parties relating to Transit Expansion which have been appropriately disclosed in note 16 of the consolidated financial statements. As well, the TTC has been fully subsidized by the City for all eligible expenditures incurred to date.

3. Summary of unadjusted items

We have concluded that the financial statements taken as a whole are free of material misstatement and pending the completion, to our satisfaction, of the outstanding matters identified in section 1, we are prepared to issue an unqualified opinion on the financial statements.

Our responsibility is to issue an opinion as to whether the financial statements are free of material misstatement.

Under Canadian GAAS, we are required to communicate to you unadjusted items and the effect that they may have on our opinion. As a result of our audit, we identified one item and have discussed with management.

Management has concluded that the unadjusted item, which is summarized below is immaterial. There are no unadjusted differences that relate to prior periods.

In addition, no items were adjusted by management as a result of our audit.

Unadjusted misstatement

Description (presented in thousands)	Surplus Over / (Under) Stated	Financial Assets (Over) / Under Stated	Liabilities Over / (Under) Stated	Non-Financial Assets (Over) / Under Stated	Opening Accumulated Surplus Over / (Under) Stated
Current year unadjusted misstatements:					
Understatement of accounts payable and cash The TTC incorrectly understated accounts payable and cash, by not reversing a cancelled check relating to a payable for 2012 in the amount of \$1.2 million Dr. Cash & Cash equivalents Cr. Accounts Payable & Accruals	-	1,159	(1,159)	-	-
Overstatement of gain on sale The TTC incorrectly overstated the gain on sale of subway cars by not writing off the remaining net book value of the H6 subway cars sold. Dr. Miscellaneous operating revenue Cr. Tangible Capital Assets	1,495	-	-	(1,495)	-
Total unadjusted misstatements	1,495	1,159	(1,159)	(1,495)	-

As a result of our audit, we conclude that the above unadjusted item is immaterial, individually and in aggregate, to the consolidated financial statements taken as a whole.

4. *Other required communications*

Canadian GAAS requires that the external auditor communicate certain matters to the Audit Committee that may assist you in overseeing management's financial reporting and disclosure process.

Below, we summarize these required communications as they apply to the TTC:

Matter to be communicated	PwC's response
Management's representations	<ul style="list-style-type: none"> • Under Canadian GAAS, we are required to inform you of the representations we are requesting from management. A copy of the management representation letter is included in Appendix B.
Significant deficiencies in internal control	<ul style="list-style-type: none"> • Canadian GAAS requires us to communicate to the Audit Committee internal control weaknesses identified as part of our audit that are considered to be significant deficiencies. We did not identify any significant control deficiencies during our audit. • During our audit, we identified a number of control observations that we have discussed with management and wish to bring to your attention. Please see Appendix D for a copy of our management letter.
Other information in documents containing audited financial information	<ul style="list-style-type: none"> • Once completed, we will review the TTC Annual Report for consistency with the audited financial statements
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none"> • No difficulties or disagreements occurred while performing our audit that requires the attention of the Audit Committee.
Fraud and illegal acts	<ul style="list-style-type: none"> • No fraud involving senior management, employees with a significant role in internal control or that would cause a material misstatement of the financial statements, came to our attention as a result of our audit procedures

5. *Internal control recommendations*

The purpose of our audit was to enable us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation 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 internal control.

During our audit, we identified the following control recommendations that we have discussed with management and wish to bring to your attention. Please see Appendix D for a copy of our management letter.

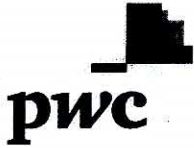
6. 2012 audit fees

a. Fees

The fees detailed below are in accordance with our response to the City's Request for Proposal covering the five year contract period for the years ended December 31, 2010 through to 2014.

Service description	Fees for year ended December 31, 2012 \$	Fees for year ended December 31, 2011 \$
Audit of the TTC consolidated financial statements	62,080	57,840
Total	62,080	57,840

Appendix A: auditor's report



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