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REPORT FOR ACTION

Draft 2016 Audited Consolidated Financial Statements

Date: April 20, 2017
To: The Atmospheric Fund Board of Directors
From: Director of Finance

SUMMARY

Draft 2016 Audited Consolidated Financial Statements have been prepared by Welch LLP and, along with their Report to the Board of Directors, are attached for Board review.

Please note that auditors have qualified their audit opinion (page 2 of Attachment #1 - the Draft Financial Statements) due to the disclosure method of one direct investment which does not comply with the accounting standards under which TAF reports. This is the first item covered below in the Balance Sheet section.

RECOMMENDATIONS

The Director of Finance recommends that The Atmospheric Fund Board of Directors approve the 2016 Audited Consolidated Financial Statements.

FINANCIAL IMPACT

None

COMMENTS

Note - Page numbers refer to Attachment #1.

A - Balance Sheet – *see page 3*
Investments Held in Trust by the City of Toronto – this asset line totals $42.9M and is fully supported by Note 6 (page16) which details TAF’s investment holdings.

The auditors' qualification is related to the line at the bottom of Note 6 called "Limited Partnership Units and private equity shares at cost" totaling $505K. This line includes TAF's ownership of a non-controlling interest percentage of common shares of Efficiency Capital Corporation ("ECC") which is reported at TAF's $3K initial cost.

The key reason for the qualification is that TAF has significant influence over ECC which implies that the "equity method" of accounting and disclosure would apply. Under this alternate disclosure method, TAF would be reporting its share of ECC's profits and losses and ECC's summary level financial statements would be included in TAF's financial statements.

The key argument for staying with the present method of disclosure is that TAF has made a considerable investment in this private sector start-up, which is still being incubated by its investors. Thus disclosing ECC's financial position in TAF's published statements may put ECC at a competitive disadvantage and harm ECC's investors.

Moreover, a qualified audit opinion related to this one specific investment has a negligible impact on TAF operations. And over time, should TAF divest of its ECC holdings, and/or have less influence over ECC, the reason for the qualification may no longer be applicable.

Loan Payable – this new line of $679K is the first advance on the $2.55 million loan from the Federation of Canadian Municipalities to finance energy efficiency retrofits in buildings owned by the Toronto Community Housing Corporation as explained in Note 11 (page 20 of Attachment 2b).

Province of Ontario Fund $17M – In mid-November 2016, $17 million was deposited by the Province into a new bank account set up for the Ontario-funded endowment. As guided by TAF's Investment Committee, these funds were promptly invested in fixed income products with TDAM. During fiscal 2017, TAF is gradually shifting a large portion of those funds into equities as guided by TAF's investment policies approved by the City of Toronto.

TAF's consolidated results for 2016 include those of the Ontario-funded endowment for the last 6 weeks of fiscal 2016, consisting of net portfolio revenues of $4K and allocated administrative expenses of $14K.

<u>B- Statement of Operations</u> – *see page 6*

Revenues:

Investment Income from marketable securities line only includes "realized" income based on TAF actually selling some of its marketable investments. Our significant "unrealized" pool of "paper gains" accumulated by marketable securities is reported on page 5, which focuses on "re-measurement gains and losses". Below we elaborate on the implications of this method of disclosure of marketable securities investment revenues.

It should be noted that starting with this year's statements, all revenues related to Energy Savings Performance Agreements ("ESPA") are now disclosed in a separate line. This new line, "Energy Savings Performance Agreement revenues," includes a $395K sale of ESPA future income streams to a foundation.

External Funding – the increase during the year reflects TAF's significant progress in the energy efficiency retrofit project for Toronto Community Housing buildings leading TAF to recognize $378K of previously deferred revenues from the Federation of Canadian Municipalities.

Expenses:
In general TAF's expenses reflect higher program delivery activity level during the year, including use of contract staff.

Disclosure of Realized vs Unrealized Investment Income from Marketable Securities - The following key disclosure method must be highlighted to better understand its implications with respect to TAF's "bottom line".

As of the 2013 year-end, TAF made a full transition to the Public Sector Accounting Standards for Not-for-Profit Organizations which had a significant impact on TAF's Statement of Operations, and specifically on the 'bottom line' called Excess of Expenditures over Revenues.

Prior to the above change, TAF's portfolio of marketable securities was "marked-to-market" whereby *all* portfolio gains or losses (i.e., realized and unrealized "paper gains" and foreign exchange gains or losses) were all combined and reported in *one* revenue line called "Investment Income" in the Statement of Operations. However, under the above disclosure rules, it is the "realization" status of investment gains which determines in which financial statement such gains are presented.

Thus, under the above disclosure rules, TAF's "realized gains" flow through the Investment Income revenue line in the Statement of Operations as before, but the "unrealized gains" are <u>only</u> included in the new statement called the Re-measurement Gains and Losses Statement.

In summary, despite reporting "operating deficits" under the above disclosure method, all investment portfolio gains (i.e. both realized and unrealized gains) contribute to TAF's "net worth" (i.e. Net Asset Value or NAV).

In general, the operating deficit is lower in years when TAF redeems more of its publicly-traded investments, i.e. when TAF realizes more gains from its portfolio investments by turning them into cash. TAF's redemptions are driven by its needs to cover its operations (including grants); to re-allocate publicly-traded securities into Direct Investments, or to meet investment portfolio weight targets under the SIOP policy.

TAF's Net Asset Value (NAV) was $45.7 million at the end of fiscal 2016 consisting of City of Toronto's $28.6M fund and Province's new contribution of $17M, thereby continuing our trend of NAV growth.

$ in 000's	**2012**	**2013**	**2014**	**2015**	**2016**
A - Operating (Deficit) for the year	($ 583)	($ 737)	($ 31)	($ 425)	($790)
B - Accumulated Re-measurement gains, end of year	$ 1,435	$ 4,984	$ 6,629	$9,439	$10,354
Net Asset Value (NAV)	**$ 21,667**	**$ 24,479**	**$ 26,092**	**$ 28,476**	**$28,602+ $17,000**

Overall, after netting revenues and expenses, and taking into account our disclosure practice of only including realized gains from marketable securities, TAF's draft audited consolidated results show an operating deficit of $790 (page 6) for the year compared to the budgeted deficit of $320K (Note 18 - page 21).

In keeping with best practices in endowment management, investment portfolio surpluses which exceed the budgeted investment rate of return are contributed to the Stabilization Fund. Thus the Stabilization Fund is part of TAF's endowment capital (or its net asset value (NAV)) to be used in "lean" years to reduce investment revenue variability due to financial market fluctuations. The investment portfolio performance shortfall of fiscal 2016 was easily covered from TAF's Stabilization Fund which totalled a robust $7.0 million at the end of 2016.

TAF had a successful year and is in a strong financial position to engage its larger asset base to support its new scope of operations covering the Greater Toronto and Hamilton areas.

CONTACT

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SIGNATURE

Richard Rysak
Director of Finance

ATTACHMENTS

1. Draft Consolidated Financial Statements for Toronto Atmospheric Fund for the year ended December 31, 2016

2. Auditors' Report to the Board of Directors - draft