

APPENDIX A

Financial Statements

City of Toronto Sinking Funds
December 31, 2017

July____, 2018

Independent Auditor's Report

To the Members of Council of the City of Toronto

We have audited the accompanying financial statements of City of Toronto Sinking Funds, which comprise the statement of financial position as at December 31, 2017 and the statement of operations and changes in unrestricted surplus, 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 financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting described in Note 2 to the financial statements, 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 City of Toronto Sinking Funds as at December 31, 2017 and the results of its operations, change in its net financial assets and its cash flow for the year then ended in accordance with the basis of accounting described in Note 2 to the financial statements.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to Note 2 to the consolidated financial statements which describes the basis of accounting. The consolidated financial statements are prepared for management and to the Members of Council to assess the City of Toronto Sinking Funds. As a result, the consolidated financial statements may not be suitable for another purpose. Our report is intended solely for the Members of Council and management and should not be used by any other parties.

DRAFT**Chartered Professional Accountants, Licensed Public Accountants**

**CITY OF TORONTO SINKING FUNDS
STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2017**

	2017	2016
	\$	\$
	[in thousands]	
ASSETS		
Current		
Cash	1,631	67,017
Investments <i>[note 3]</i>	1,741,064	1,854,635
Total current assets	1,742,695	1,921,652
LIABILITIES AND NET ASSETS		
Current		
Accounts payable and accrued liabilities	16	23
Total current liabilities	16	23
Actuarial requirements <i>[note 5]</i>	1,604,283	1,723,097
Total liabilities	1,604,299	1,723,120
Net assets		
Unrestricted surplus <i>[note 4]</i>	30,442	44,536
Internally restricted surplus <i>[note 4]</i>	107,954	153,996
Total surplus	138,396	198,532
	1,742,695	1,921,652

**CITY OF TORONTO SINKING FUNDS
STATEMENT OF OPERATIONS AND CHANGES IN UNRESTRICTED SURPLUS
FOR THE YEAR ENDED DECEMBER 31, 2017**

	2017	2016
	\$	\$
	[in thousands]	
REVENUES		
Contributions	282,920	244,633
Investment income <i>[note 6]</i>	38,130	27,792
	321,050	272,425
EXPENSES		
Provision for actuarial requirements <i>[note 5]</i>	381,186	376,575
Deficiency of revenues over expenses for the year	(60,136)	(104,150)
Surplus, beginning of year	198,532	302,682
Total surplus, end of year	138,396	198,532

**CITY OF TORONTO SINKING FUNDS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017**

CASH PROVIDED BY (USED IN)	2017	2016
	\$	\$
	[in thousands]	
OPERATING ACTIVITIES		
Deficiency of revenues over expense for the year	(60,136)	(104,150)
Deduct items not involving cash		
Amortized discount on investments	5,695	15,632
Increase in accrued interest	2,374	3,272
Unrealized loss on investments	22,313	41,142
Increase in actuarial requirements	381,186	376,575
	351,432	332,471
Changes in non-cash working capital balances related to operations		
Decrease in accounts payable and accrued liabilities	(7)	(7)
Cash provided by operating activities	351,425	332,464
INVESTING ACTIVITIES		
Purchase of investments	(360,105)	(286,151)
Proceeds from maturities of investments	388,984	440,773
Proceeds from sale of investments	54,310	52,627
Cash provided by (used in) investing activities	83,189	207,249
FINANCING ACTIVITIES		
Maturity of debenture	(500,000)	(475,000)
Cash used in financing activities	(500,000)	(475,000)
Increase (decrease) in cash during the year	(65,386)	64,713
Cash, beginning of year	67,017	2,304
Cash, end of year	1,631	67,017

**CITY OF TORONTO SINKING FUNDS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

1. PURPOSE OF SINKING FUNDS

The City of Toronto Sinking Funds [the Sinking Funds] accumulate 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 (*Appendix B - Schedule Of Projection Of Debenture Maturities*) 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 Funds are governed under the City of Toronto Act, 2006 (No. 2) Statutes of Ontario, 1997, Chapter 26 and are exempt from income taxes under Section 149(1) of the Income Tax Act (Canada).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian public sector accounting standards, except that investments are recorded at fair value. The significant accounting policies are summarized below.

(i) Revenue recognition

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

(ii) Financial instruments

Financial assets include cash and investments. Cash is recorded at amortized cost, which approximates fair value. The Sinking Funds invest in debentures issued or guaranteed by provincial and municipal governments and corporate bonds. The value of investments recorded in the financial statements is the fair value based on the latest bid prices and the change in fair values is included in the statement of operations. The Sinking Funds also invest in short-term investments comprised of money market instruments, such as guaranteed investment certificates and are valued based on cost plus accrued income, which approximates fair value. The Sinking Funds' investment activities expose it to a range of financial risks, including market risk, credit risk, and liquidity risk (Note 7). The Sinking Funds do not invest in equity or foreign investments.

**CITY OF TORONTO SINKING FUNDS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

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

Sinking Fund 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 investment income and interest income, net of bank service charges, audit fees and unrealized gain (loss) on the increase/decrease in the fair value of the investments.

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

(ii) Management estimates and Sinking Fund requirements

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets, liabilities and surplus at the reporting date and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The area where the most judgment is applied is with respect to the actuarial requirements of the Sinking Funds. The provision for actuarial requirements of the Sinking Funds for the year represents the amounts levied during the year as set out in the Sinking Funds debenture bylaws plus interest accrued thereon compounded at the Sinking Fund rates of 3.5%, 4%, or 5% per annum on debt issued in 1997 and thereafter; and 2.0%, and 2.5% per annum on debt issued in 2015 and thereafter.

The Sinking Fund requirements are expected to accumulate to an amount sufficient to pay the related debentures on maturity. The excess of revenue over these requirements for the year is included in the fund balance.

**CITY OF TORONTO SINKING FUNDS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

3. INVESTMENTS

Investments consist of the following:

	Fair value	Face value
	\$	\$
	[in thousands]	
2017		
Debt investments issued or guaranteed by:		
Provincial governments	1,222,136	1,414,983
City of Toronto	124,076	106,108
Other Canadian municipalities	237,175	219,294
Corporations	157,677	156,915
Total	1,741,064	1,897,300
2016		
Debt investments issued or guaranteed by:		
Provincial governments	1,147,435	1,296,194
City of Toronto	134,303	118,285
Other Canadian municipalities	241,108	220,700
Corporations	331,789	325,512
Total	1,854,635	1,960,691
	2017	2016
	\$	\$
	[in thousands]	
Amortized cost	1,683,567	1,772,449
Weighted average yield	3.84%	3.97%
Average term to maturity	5.97 years	5.35 years
Excess of fair value over amortized cost	57,497	82,186

**CITY OF TORONTO SINKING FUNDS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

4. NET ASSETS

Total surplus consists of the following:

	2017	2016
	\$	\$
	[in thousands]	
City of Toronto unrestricted deficit	(24,393)	(31,598)
Toronto District School Board deficit	-	(1,014)
Total unrestricted deficit based on amortized cost	(24,393)	(32,612)
Unrealized gain on investments	54,835	77,148
Total unrestricted surplus	30,442	44,536
Internally restricted surplus	107,954	153,996
Total net assets	138,396	198,532

5. SINKING FUND REQUIREMENTS

The change in the Sinking Fund requirements for the year is as follows:

	2017	2016
	\$	\$
	[in thousands]	
Sinking Fund requirements, beginning of year	1,723,097	1,821,522
Add provision for Sinking Fund requirements	381,186	376,575
	2,104,283	2,198,097
Less par value of debentures matured during the year	500,000	475,000
Sinking Fund requirements, end of year	1,604,283	1,723,097

**CITY OF TORONTO SINKING FUNDS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

6. INVESTMENT INCOME

	2017	2016
	\$	\$
	[in thousands]	
Investment income	59,758	68,479
Interest income	685	455
Unrealized loss on change in fair value	(22,313)	(41,142)
Total investment income	38,130	27,792

7. FINANCIAL INSTRUMENTS

The Sinking Funds are subject to market risk, credit risk, and interest rate price risk with respect to its investment portfolio. The Sinking Funds' interest bearing investments are exposed to interest rate risk. The Sinking Funds' investments are at risk due to fluctuations in market prices whether changes are caused by factors specific to the individual investment or factors affecting all securities traded in the market. The Sinking Funds manage risk by investing across a wide variety of asset classes and investment strategies.

The Sinking Funds hold investments in fixed income securities issued by corporations and government entities and as such have fixed income credit risk. The Sinking Funds mitigate this risk by limiting the investment portfolio to investments in BBB grade or higher.

The Sinking Funds' liquidity risk is the risk of being unable to settle or meet commitments as they come due. These commitments include payment of the funding obligations of the Sinking Funds. Liquidity risk is managed by ensuring the Sinking Funds invest in securities that are actively traded.

8. 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. The need for sufficient liquid resources is considered in the investment process. As at December 31, 2017, the Sinking Funds have met their objective of having sufficient liquid resources to meet current obligations.

CITY OF TORONTO SINKING FUNDS
APPENDIX B - SCHEDULE OF PROJECTION OF DEBENTURE MATURITIES
FOR THE YEAR ENDED DECEMBER 31, 2017

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

	\$
	[in thousands]
2018	425,000
2019	400,000
2021	650,000
2023	300,000
2024	300,000
2025	300,000
2026	300,000
2027	400,000
2035	400,000
2036	400,000
2040	600,000
2041	450,000
2042	300,000
2044	300,000
2046	500,000
	<u>6,025,000</u>