

Unpacking the City's Financial Statements - Purpose, Responsibilities, and Major Components

Overview of the City's Financial Statements

On an annual basis, the City of Toronto (City) presents three sets of financial statements (Statements) to Audit Committee (Committee) for adoption prior to submission to Toronto City Council (Council) for approval. These Statements are:

1. City of Toronto Consolidated Financial Statements (Consolidated Statements): The City's Consolidated Statements include the financial results of all significant entities controlled by the City. In addition to all City divisions, these Consolidated Statements include entities such as the Toronto Police Service, Toronto Transit Commission and the Toronto Atmospheric Fund. The City's decision to consolidate an organization is made in accordance with PSAS, which includes a consideration of practicality. Organizations that do not meet the City's financial reporting requirements are not consolidated. A complete list of these entities is provided in Note 1 of the Consolidated Statements.
2. City of Toronto Sinking Funds Statements (SF Statements): When the City issues debentures (debt), the City of Toronto Act, 2006, requires that the principal repayment be amortized over the term-to-maturity of the debt or that an annual amount be contributed to a sinking fund. As a result, Sinking Funds are used to accumulate annual contributions and investment earnings in order to build up balances required to repay City Sinking Fund debt when it matures. The SF Statements present the financial position and performance of the City's Sinking Fund investments and liabilities. The Sinking Fund balances presented separately in these SF Statements form part of the City's consolidated cash and investments balances in the Consolidated Statements.
3. City of Toronto Consolidated Trust Funds Statements (TF Statements): The City and a number of its consolidated entities administer various Trust Funds, which consist of assets that have been conveyed or assigned to a trustee to be administered as directed by agreement or statute. The TF Statements outline the financial position and performance of these assets, which are maintained for the purpose of providing benefits to the noted beneficiary. Appendix D of the TF Statements provides the description and purpose of each Trust Fund.

Section 231 and 232 of the City of Toronto Act, 2006 (Act) requires that the City prepare and publish the above annual Statements in accordance with Generally Accepted Accounting Principles (GAAP) established by the Chartered Professional Accountants of Canada's Public Sector Accounting Board (PSAB). As the City is a public sector organization, the City's Statements follow Public Sector Accounting Standards (PSAS).

The City publishes its Statements, as well as additional information concerning its finances, operations, and climate-related matters in the Annual Financial Report, which is available on the City's website: [Annual Financial Report](#).

The City's Statements containing the external auditor's opinion are published as part of the Annual Financial Report after receiving Council's approval.

Major Components of the City's Statements:

The City's Statements consist of four major components:

- Statement of Financial Position: provides an overview of key financial balances, including what is owned (e.g. cash, investments and tangible capital assets) and owed (e.g. accounts payable and long-term debt) as at December 31st;
- Statement of Operations and Accumulated Surplus: outlines the current fiscal year's revenues, expenses, and accounting surplus/deficit based on management's decisions;
- Statement of Change in Net Debt: outlines how changes in non-financial assets, including tangible capital assets, affected the net debt balance. The Statement of Change in Net debt is an important financial statement, especially as net debt represents the future revenue required to pay for obligations arising from past transactions and services provided to residents and businesses; and
- Statement of Cash Flows: summarizes the cash position and changes resulting from the various sources and uses of cash.

It should be noted that not all of the above components may be required for each set of Statements. There are circumstances whereby certain components are not prepared as they do not provide any additional value to the users of the Statements.

Basis of Accounting: Differences between Budgeting and Accounting Principles

Consistent with other Canadian municipalities, the City is legislatively required to have a balanced budget and therefore, is prohibited to budget for a deficit. In order to comply with these legislative requirements, the City prepares its budget using a modified cash basis, which considers required cash inflows and expected cash outflows for a given fiscal year. As a result, there are some significant differences between how the City prepares its budget as opposed to how the Statements are presented.

Based on PSAS' financial reporting framework, the Consolidated Statements are presented on an accrual accounting basis, which allows the City to disclose the long-term financial implications associated with its activities and decisions. PSAS provides standards for the recognition of assets and liabilities in the Statement of Financial Position; for example, capital expenditures that provide long-term benefits are recognized as Tangible Capital Assets (non-financial assets) while debentures issued are obligations that require future repayment and are therefore, recognized as Long Term Debt.

The difference in the two methodologies results in performance differences. The budget variance measures the differences between expected and actual cash flows in and out of the organization, resulting in annual deficiencies and requiring draws from reserves or surplus which allow for contributions to reserves. However, the accounting surplus, presented on the Statement of Operations and Accumulated Surplus, represents the difference between revenues and expenses recognized using PSAS, which considers

when revenues are earned and expenses incurred, regardless of when the cash is received or used to make a payment. In order to properly reflect comparability, the budget information reflected in the Statement of Operations and Accumulated Surplus has been converted from modified cash basis to accrual accounting basis, where possible, to incorporate PSAS principles.

The Consolidated Statements include a separate reconciliation to illustrate these key differences, such as the recognition of tangible capital assets and associated amortization costs, and why an accounting surplus is recognized when the City may be in smaller cash surplus, or even deficit, position.

Responsibility for the Preparation of the City's Statements:

The preparation, content and accuracy of the City's Statements, and all other information included in the Annual Financial Report, is the responsibility of management, as outlined in PSAB's financial reporting framework. Management is responsible for ensuring that appropriate internal controls are developed, maintained, and applied to ensure fair presentation of the financial statements. In addition, management must record and report transactions in accordance with PSAS to ensure that its overall financial information has been fairly represented.

The City's Statements are ultimately reviewed and approved by the Chief Financial Officer and Treasurer (CFO), and the Controller. The City Manager, CFO and the Controller's approvals collectively represent management's representation to the City's external auditors regarding the accuracy, completeness and existence of financial information incorporated in the Statements.

Responsibility for the Audit of the City's Statements:

The City's external auditors, KPMG, are responsible for providing an opinion on the fair presentation of the Statements in accordance with PSAS. KPMG executes audit procedures in accordance with Canadian Auditing Standards in order to gather sufficient and appropriate audit evidence with which to form an opinion on the City's Statements. In performing their work, KPMG may recommend adjustments to the balances reflected in the Statements or their accompanying note disclosures, as well as suggest improvements to management's internal processes and internal controls.

Given the size of the City's operations, the external auditors complete their audit of the Statements in two phases: interim and year end.

Prior to year-end, KPMG performs interim audit procedures in order to assess areas of risk in the audit process, in addition to assessing materiality, which is a value that determines the importance and significance of an amount, transaction or discrepancy that could affect the economic decision making of the users of the financial statements. Subsequent to the interim audit, KPMG provides a copy of the Audit Planning Report to summarize the overall work plan, materiality, and areas of significant risk that will be evaluated as part of the year-end season. A copy of the most recent Audit Planning Report is available on the City's website: [Year End 2022: Audit Planning Report](#).

At the conclusion of the audit, management and Committee are presented with KPMG's Audit Findings report, which provides highlights of the year-end audit, details corrected and uncorrected errors noted during the audit and describes any control deficiencies which the auditors may have noted during the execution of their audit procedures. The previous years' Audit Findings report is located here: [City of Toronto: Audit Findings Report for the year ended December 31, 2021](#).

In performing their audit planning and procedures, KPMG gains an understanding of the City's internal controls over financial reporting; these are the controls implemented and executed by the organization to recognize and record transactions that ensure the fair presentation of the City's Statements. As a result of this work, KPMG issues a year-end management letter which highlights control deficiencies and process improvement opportunities for management to consider in order to strengthen the overall control environment over financial reporting. KPMG's 2020 management letter to the City can be found here: [2020 Management Letter from KPMG](#). The Controller's presentation to Audit Committee on the status of the implementation of KPMG's recommendations can be found here: [2021 Controller's Presentation MLP implementation](#).