A MESSAGE FROM THE CHIEF FINANCIAL OFFICER AND TREASURER

With the close of 2003, the City of Toronto has registered a positive financial performance for the sixth year since amalgamation, despite numerous challenges. Unique 2003 events, such as the Severe Acute Respiratory Syndrome (SARS) outbreak and the August power blackout posed a challenge which resulted in lower program revenues, but they were offset by continuous improvement initiatives and a discretionary spending freeze.

In September 2002, Moody's Investors Service upgraded the City's credit rating for long-term debt from Aa2 to Aa1. All three credit rating agencies confirmed their ratings in 2003 and rank Toronto as superior to many large urban centres in the rest of Canada and the world.

These ratings acknowledge the City's financial strength, including a strong and diversified economy, good fiscal management, strong financial controls, modest debt levels, and the re-emergence of the provincial government as a partner in the funding for transit infrastructure.

2003 financial highlights include:

- Cash and investments increased by $281 million to a total of $2.222 billion.
- The City's investment in its government business enterprises increased by $123 million to a total of $942 million.
- Toronto Community Housing Corporation's mortgage debt declined by $18.8 million.
- Reserve and reserve fund balances increased by $42 million to $933 million.

Other financial results relating to the City's liabilities include:

- The City collected revenues of $7.247 billion and spent $7.384 billion for a net consolidated expenditure of $138 million before long-term financing. As a result, the City's net financial liabilities increased from $1.5 billion to $1.64 billion.
- Interest bearing net long-term debt to third parties increased by $134 million to stand at $1.477 billion at the end of the year.
- The employee benefit liability increased by $137 million to $1.792 billion.

Although the City's financial position is strong, these results reflect a growing trend that the City is less and less able to meet its rising program costs from its primary source of revenue: property taxation.

In 2003 the City began to develop a Long-term Fiscal Plan, which is to be used as a blueprint for future financial planning and discussions with funding partners. A New Deal with other orders of government must provide the City with the appropriate and sustainable funding tools to meet the rising costs of programs.

In summary, the City of Toronto Finance Department will continue to implement service efficiencies and best practices, together with improved financial controls and accountability, and prudent financial planning, to better serve all Toronto taxpayers.

Joseph Pennachetti
Chief Financial Officer & Treasurer

TREASURER'S REPORT

On an annual basis, as required by the Municipal Act, the City prepares and publishes an annual financial statement that consolidates all of its operations. The Consolidated Financial Statements show the state of the City's finances at the end of each fiscal year.

The financial statements must be prepared in accordance with the generally accepted accounting principles as set by the Canadian Institute of Chartered Accountant's (CICA) Public Sector Accounting Board (PSAB). To ensure that the statements are in compliance, they are subjected to external audit by an independent auditor.

The Consolidated Financial Statements encompass the following individual statements:

Name	Purpose
Consolidated Statement of Financial Position	Provides a summary of the City's financial assets and liabilities
Consolidated Statement of Financial Activities	Provides a summary of funds raised by the City and the use of such funds in the year. This statement reflects the combined operations of the operating, capital, reserve and reserve funds for the City and its consolidated entities.
Consolidated Statement of Cash Flow	Summarizes how the City's cash and short-term investments changed during the year by highlighting the City's sources and uses of cash.
Analysis of Current Operations	Outlines funds raised by the City in the year for current operations and what those funds were used for and how they compared to the budget.
Analysis of Capital Operations	Provides a summary of funds raised by the City in the year for capital operations and what those funds were used for and how they compared to the budget.
Analysis of Reserves and Reserve Funds	Summarizes funds raised by the City in the year for reserve funds and what those funds were used for and how they compared to the budget.

The consolidated financial statements combine the financial results of the City's departments with the financial results of the agencies, boards, commissions (ABCs) and government business enterprises that the City effectively controls. There are 75 entities that are included in the financial statements and these are listed in Note 1 to the Financial Statements. The remaining notes to the financial statements provide further detail about the City's financial results and are an integral part of the statements.

Under PSAB rules, only the Consolidated Statement of Financial Position, Consolidated Statement of Financial Activities and Consolidated Statement of Cash Flow are required statements. However, to aid understanding of the financial statements, schedules have been prepared for current operations, capital operations and reserves and reserve funds.

Consolidated Statement of Financial Position

The Consolidated Statement of Financial Position is sometimes referred to as the municipal equivalent of the private sector's balance sheet. However, there is one important distinction in that the net book value of the City's physical or "fixed" assets (land, infrastructure, buildings and equipment) are not disclosed. Instead, this statement focuses on the City's financial assets and financial liabilities. The difference between the two is the City's net liability position and represents the net amount that must be financed in future budgets.

The City's net liabilities are detailed in the "Municipal Position" portion of the statement. The net liability is divided between the funds (assets) the City has set aside for future purposes and the gross amount of the City's debt that are intended to be funded in the future. The City has three funds:

Operating and Capital Funds

The Operating Fund is primarily made up of the City's financial interest in its government business enterprises which consist of Toronto Hydro, Toronto Parking Authority, Toronto Economic Development Corporation (TEDCO) and Enwave. The fund includes the net financial interest in the City's agencies, boards and commissions (ABCs) of which the Toronto Transit Commission (TTC) is the most prominent. The smallest portion of the fund represents the previous year's City surplus.

Capital Fund

The Capital Fund represents the net position of the City's capital projects. If the fund is in a deficit position, as it is in 2003, it indicates that the financing (such as a debt issuance) for these projects has yet to occur.

Reserves and Reserve Funds

The Reserves and Reserve Funds represent past revenues and contributions that have been set aside for future use. The majority of these funds are earmarked for future capital financing and for stabilizing the peaks and valleys of operating expenditures and revenue levels from year to year. A break down of the City's reserves and reserve funds can be found in Appendix 1 to the Financial Statements.

In addition to the reserves and reserve funds, the City also has deferred revenues that are funds that the City has received in advance for specific purposes that will occur in the future. For example, developer charges and parkland dedication fees received are not recognized as revenues until such time as the projects for which the funds were raised are constructed. A breakdown of the City's deferred revenues can be found in Note 5 to the Financial Statements.

Consolidated Statement of Financial Activities

The Consolidated Statement of Financial Activities is often viewed as the municipal equivalent to the private sector's income statement. However, like the Statement of Financial Position, there is an important distinction. Although the statements are on an accrual basis of accounting for most assets and liabilities, they are not based upon "full" accrual accounting in that the cost of the City's physical assets are not amortized and depreciated over their useful life. Instead, the costs of the City's physical assets are expensed 100% in the year they are purchased or built.

The statement provides a summary of the source, allocation and use of the City's financial resources throughout the reporting period. This statement reflects the combined operations of the operating, capital, reserves and reserve funds for the City and its consolidated entities.

The focus of this statement is the net expenditure/revenue figure found in the middle of the statement. A net expenditure figure represents an amount that the City has to finance from sources other than operating revenue. A net revenue figure represents an amount that the City could use to repay past financing or could set aside in reserves for future use. The financing section of the statement below this figure outlines the new long-term debt the City has issued (debentures) or assumed (employee benefits, solid waste obligation) in the year and the debt retired in the year.

2003 HIGHLIGHTS

The City collected revenues of $7.247 billion and spent $7.384 billion for a net consolidated expenditure of $138 million before long-term financing. As a result, the City's net financial liabilities increased by $138 million from $1.5 billion to $1.64 billion.

- The level of unfinanced capital expenditure was reduced by $261 million.
- Cash and investments increased by $281 million to a total of $2.222 billion.
- The City's investment in its government business enterprises increased by $123 million to total $942 million.
- Interest bearing net long-term debt to third parties increased by $134 million to stand at $1.477 billion at the end of the year.
- TCHC's mortgage debt declined by $18.8 million to a total of $1.017 billion at year's end.
- Employee benefit liabilities increased $137 million to $1.792 billion.

ANALYSIS

Current Operations - Budget to Actual Comparison

The City was able to generate net revenues that were in excess of budget despite the impacts of the SARS outbreak and the Province-wide electricity blackout in August 2003.

Net Revenues	2003 (in thousands of dollars) Budget	Actual	Difference
Property tax revenues	3,007,261	2,983,563	(23,698)
User charges	1,647,001	1,619,057	(27,944)
Government transfers	1,613,853	1,564,621	(49,232)
Other revenues	453,621	597,840	144,219
	6,721,736	6,765,081	43,345
Expenditures	6,400,504	6,407,681	(7,177)
Net revenues before Long-term financing	321,232	357,400	36,168

Property taxes were lower than expected primarily because of a shortfall in payments-in-lieu-of-taxes (PILs) from other orders of government. SARS and the August 2003 blackout had negative impacts on the City's user charges particularly transit fares and recreational fees. Government transfers were under budget due to reduced spending in cost shared social assistance and child care programs.

Other revenues were in excess of budget due to stronger than expected investment earnings (as a result of a larger investment base and a slightly higher rate of return) and because earnings from the City's government business enterprises are not reflected in the budget figures. Note 2 of the Financial Statements provides more information on the City's investments and results. Note 4 and Appendix 2 to the Financial Statements provide more detail on the City's government business enterprise results.

Expenditures	2003 (in thousands of dollars) Budget	Actual	Difference
General government	436,593	478,387	(41,794)
Protection to persons and property	1,041,627	1,149,021	(107,394)
Transportation	1,319,002	1,322,586	(3,584)
Environmental services	527,783	537,799	(10,016)
Health services	264,195	286,938	(22,743)
Social and family services	1,572,963	1,451,508	121,455
Social housing	700,467	656,785	43,682
Recreational and cultural services	504,004	491,526	12,478
Planning and development	33,870	33,131	739
Total	6,400,504	6,407,681	(7,177)

Employee benefits are budgeted for by the City on a cash basis. As a result, the 2003 budget does not include $137 million of employee benefit costs that have been incurred but are payable in future years whereas the actual expenditure figures include these costs. In addition, there is a further $63 million in WSIB claims, retiree benefits, sick leave pay-outs and employee separation costs that have been allocated to the actual cost of programs for which there is no corresponding program expenditure budget. These costs were largely incurred prior to amalgamation, and are financed from reserves. The reserves are in turn replenished from budgeted reserve transfers that are part of the financing section of the statement of financial activities.

General government expenditures include the costs of Council, CAO, Auditor General, Facilities & Real Estate, Finance, Clerk's, Human Resources, Corporate Communications, Information & Technology, Legal, consolidated grants, computer leases, miscellaneous non-program costs and the allowance for property tax appeals. The departmental expenditures were largely under budget due to the spending freeze imposed in the last four months of 2003. The allowance for property tax appeals was under budget by $19.3 million as the number of outstanding assessment appeals has been reduced.

Self-insured general insurance claims which are also included in general government amounted to $33 million. Unlike the employee benefits mentioned above, these costs have not been allocated to the programs. However, like the employee benefits, these costs do not have a corresponding expenditure budget as they are financed from the self-insurance reserve. This reserve is in turn replenished from a budgeted reserve transfer that is part of the financing section of the statement of financial activities.

Protection to persons and property expenditures include the cost of Police, Fire, Building Services, Conservation Authority levies and the Provincial Offences Act (POA) Courts. Actual costs were higher than budget largely due to employee benefit liability charges to Police (resulting from the recent actuarial review) and wage settlements to Fire.

Environmental services expenditures include the cost of the Solid Waste program which increased due to higher landfill costs (Michigan) and the waste diversion program necessitated by the closing of the Keele Valley Landfill site in 2002.

Health Services combines Emergency Medical Services and the Toronto Public Health Service. Extra costs were incurred in this program to respond to SARS.

Social and family services expenditures were under budget due to less demand on social assistance, shelter and support beds and a reduction in the number of subsidized child care spaces. Social housing costs were lower than budget as a result of improved TCHC financial results.

Recreational and Cultural Services includes parks, recreation, cultural services, the Library Board, and other related City ABCs (e.g. Exhibition Place, Toronto Zoo, Hummingbird Centre).

Comparison to the prior year

Net revenues	2003 Actual	(in thousands of dollars) 2002 Actual	Difference
Property tax revenues	2,983,563	2,968,475	15,088
User charges	1,619,057	1,625,970	(6,913)
Government transfers	1,564,621	1,446,026	118,595
Other revenues	597,840	561,531	36,309
	6,765,081	6,602,002	163,079
Expenditures	6,407,681	6,114,130	293,551
Net revenues before long-term financing & transfers	357,400	487,872	(130,472)

Property tax revenue increases from assessment growth and a 3% tax rate increase on residential properties were offset in part by reduced payment-in-lieu of taxes revenue from other orders of governments. Revenue from user fees in transit and recreational facilities declined as a result of SARS and the blackout. Revenue from government transfers increased in 2003 over 2002 due to several factors, including: increases in cost-shared social and health services spending; a special one-time grant from the province; transfers for exceeding Ontario Works placement target and SARS related expenditures.

Expenditures	2003 Actual	(in thousands of dollars) 2002 Actual	Difference
General government	478,387	454,758	23,629
Protection to persons and property	1,149,021	1,068,385	80,636
Transportation	1,322,586	1,234,538	88,048
Environmental services	537,799	491,041	46,758
Health services	286,938	256,202	30,736
Social and family services	1,451,508	1,406,782	44,726
Social housing	656,785	676,180	(19,395)
Recreational and cultural services	491,526	492,788	(1,262)
Planning and development	33,131	33,456	(325)
Total	6,407,681	6,114,130	293,551

Other revenues increased primarily because of improved government business enterprise earnings and increases in investment income.

Overall costs increased by 4.8% over 2002. The increase is generally attributable to wage increases and inflation as level of service delivery was essentially unchanged. Part of the increase in environmental services is related to the closure of the Keele Valley Landfill Site resulting in higher waste transportation and diversion costs. In transportation, the TTC hired additional drivers and experienced a full year's operating cost on the new Sheppard subway line that opened during 2002. In addition, the severe winter conditions in the first quarter of 2003 resulted in higher than expected winter control costs. Social housing costs decreased because of improved operating results at TCHC.

Capital Fund Budget to Actual Comparison

(in thousands of dollars)

Capital	2003 Budget	2003 Actual	2002 Actual
Expenditures	1,423,123	976,753	967,064
Revenues	668,498	388,918	380,832
Long - term debt and mortgages	439,574	300,000	152,078
Operating fund transfers	165,015	515,732	199,654
Net reserve/reserve fund transfers	148,478	38,701	(17,927)
Landfill obligations		(5,643)	29,806
Total revenue & financing	1,421,565	1,237,708	744,443
Net increase (decrease) in Fund balances	1,558	(260,955)	222,621

Capital expenditure levels were comparable to the previous year but continue to be well under budget.

The large increase in operating fund transfers is due to consolidation entries made to properly recognize the ABCs' self-funded share of their capital expenditures. The individual ABC financial statements are prepared on a commercial basis of accounting and must be converted to the City's government based accounting under PSAB rules. Upon consolidation in previous years, the ABCs' net investment in capital assets were accounted for in the Capital Fund as unfinanced capital projects.

Correspondingly, the ABCs' internal financing for these assets remained in the Operating Fund and no transfers between the two funds were made. This overstates both the Operating Fund and the unfinanced portion of the Capital Fund, but as they offset, the municipal position is unaffected. The transfers made in 2003 move the ABC funds from the Operating Fund to finance their balances in the Capital Fund. This ensures the individual fund balances are properly stated.

Current Accounts

Note 2 of the Financial Statements provides details about the City's investments and their yields. Note 3 provides more information on City's note receivable from Toronto Hydro. Information about the City's government business enterprises can be found in Note 4 and Appendix 2 to the Financial Statements.

Taxes Receivable

Taxes receivable includes all outstanding taxes at year end. These not only include property taxes, but also include items that have been added to the tax roll, such as utilities arrears, drainage charges, local improvement charges, and the accumulated penalties and interest charges against such taxes, less any allowance for uncollectable taxes. A breakdown of this receivable is noted below:

(in millions of dollars)

	2003	2002
Current year	168.9	155.5
Prior year	36.4	40.4
Previous years	35.7	32.3
Interest/penalty	29.6	27.9
Less: allowance for doubtful accounts	(23.6)	(30.7)
Net receivables	247.0	225.4

Accounts Payable

A comparison of accounts payable and accrued liabilities at December 31, 2003 with the previous year is shown below:

	(in millions of dollars)	
	2003	**2002**
Local Board trade payables	140.5	213.6
City trade payables & accruals	894.1	838.3
Payable to school board	174.2	221.3
Provision for assessment appeals	244.4	239.3
Credit balances on property tax accounts	61.0	104.0
Payroll liabilities	62.7	111.9
Total	1,576.9	1,728.4

Accounts Receivable

A comparison of accounts receivable and accrued amounts owed to the City at December 31, 2003 with the previous year is shown below:

	(in thousands of dollars)	
	2003	**2002**
Government of Canada	14,135	15,667
Government of Ontario	1,188	40,673
Other municipal governments	1,020	1,491
School board	8,824	289,018
Water fees	100,677	106,720
Other	389,182	379,257
Total	515,026	832,826

The large school board receivable in 2002 related to capital advances paid by the City to the School Board in 2002 and prior years. In 2003, these funds were repaid when the School Board obtained new financing from the new Ontario Financing Authority.

Significant Trends

Significant trend information is provided below for selected key financial indicators over the last four years. Normally, a five-year trend is provided, however the 1999 results have not been included because of a number of significant one-time retroactive adjustments that were made in 2000 to account for the incorporation of Toronto Hydro and the consolidation of the TCHC. In addition, the employee benefit liability was not recognized until 2000. These extraordinary entries and additional disclosures distort revenue and expenditure comparisons for 2000 and 1999. Future reports will include five-year trends.

Financial Activities
Capital and Operating

		(in thousands of dollars)			
Consolidated Net Expenditures	**Avg. Annual Increase**	**2003**	**2002**	**2001**	**2000**
Revenues	4.53%	7,246,787	7,084,372	6,745,486	6,345,333
Expenditures	4.00%	7,384,434	7,081,194	6,845,850	6,563,672
Net (expenditures) revenues	A	(137,647)	3,178	(100,364)	(218,339)

The net expenditure level has averaged approximately $113 million per year. This amount is largely attributable to the employee benefit liability that the City intends to fund from future revenues. The remainder is due to capital expenditures that were funded by new long-term debt which has been deferred since 2000 to 2003/04. Financing over this time period is displayed below.

		(in thousands of dollars)			
Financing		**2003**	**2002**	**2001**	**2000**
Net new debentures and mortgages net of repayment		138,826	3,670	72,692	37,814
Increase in unfunded liabilities		131,612	135,182	170,633	87,791
Increase (decrease) in inventories and prepaid expenses		18,483	(6,454)	(14,048)	8,535
Total financing and inventory change	B	288,921	132,398	229,277	134,140
Increase (decrease) in Fund balances	(A+B)	151,274	135,576	128,913	(84,199)

The table below demonstrates that property taxes have been the slowest growing revenue source for the City. During this period, assessment growth has been minimal. Gains made by new construction have been offset by conversions of non-residential to residential properties (which is taxed at a much lower rate) and by current value property tax appeals. In addition, the City has been prohibited by provincial legislation from extending tax rate increases to the commercial, industrial and multi-residential assessment base which represents 61% of the City's tax revenue base. As a result, more reliance has been placed on user fees, government grants and other sources of revenue to meet the City's expenditures.

		(in thousands of dollars)			
Consolidated Revenues	**Avg. Annual Increase**	**2003**	**2002**	**2001**	**2000**
Property taxes	2.20 %	2,983,563	2,968,475	2,970,485	2,795,450
User charges	4.58 %	1,619,057	1,625,970	1,525,665	1,415,721
Senior government transfers	7.27 %	1,653,141	1,576,589	1,403,198	1,339,393
Other	7.64 %	991,026	913,338	846,138	794,769
Total	4.53 %	7,246,787	7,084,372	6,745,486	6,345,333

Financial Position

	(in thousands of dollars)			
Net Liabilities	**2003**	**2002**	**2001**	**2000**
Liabilities	6,643,754	6,431,411	6,236,701	5,603,089
Financial Assets & Inventory	5,145,836	5,053,657	4,861,223	4,342,023
Net Liabilities	1,497,918	1,378,754	1,375,478	1,261,066

The City's net liability has increased by an average annual rate of 5.9 % over the last four years. However, most of the increase is not attributable to interest bearing long-term debt to third parties but to employee benefit liabilities, as illustrated below.

		(in thousands of dollars)			
Net Long-Term Debt	**Avg. Annual Increase**	**2003**	**2002**	**2001**	**2000**
Third Party Debt:					
Debentures*	6.10 %	1,301,457	1,158,827	1,171,388	1,089,201
Provincial loan	(4.30 %)	175,331	183,750	183,750	200,000
TCHC Mortgages	(1.24 %)	1,017,078	1,035,843	1,041,603	1,055,800
	2.07 %	2,493,866	2,378,420	2,396,741	2,345,001
Employee Benefit Liabilities	9.18 %	1,791,750	1,654,495	1,549,119	1,376,549
Total	4.82 %	4,285,616	4,032,915	3,945,860	3,721,550

* Net after funds held in City's sinking funds

More information on the TCHC mortgages can be found in Note 7 to the Financial Statements. Note 8 provides additional information about the provincial loan and the City's debenture debt. Further detail about the City's employee benefits liabilities can be found in Note 9 to the Financial Statements.

	(in thousands of dollars)			
Reserves and Reserve Funds	**2003**	**2002**	**2001**	**2000**
Reserves	269,685	319,558	235,316	238,906
Reserve Funds	663,478	571,834	551,986	442,118
Total	933,163	891,392	787,302	681,024

Approximately 70% of the City's reserves and reserve funds represent "stabilization" reserves that are used to smooth expenditure and revenue variances from one year to the next. The remaining reserves and reserve funds are "capital" reserves that are used to fund a portion of the City's capital program. Appendix 1 to the Financial Statements provides a breakdown of the City's reserves and reserve funds.

SUMMARY:

The financial results for 2003 demonstrate clearly the need for a new financial deal with the provincial and federal governments. The City has been unable to meet its rising program costs from its main source of revenue: property taxes. Property tax revenue growth has been limited by marginal assessment growth, assessment appeals and a freeze on commercial, industrial and multi-residential tax rates. As a result, the City has relied more heavily on user fees and other sources of revenue. However, further increases in these alternate sources of revenue are now reaching their limit.

Although the City's net financial liability increased largely due to an increase in its unfunded employee benefit liability in 2003, there is a real risk that the City's financial condition will worsen if the City has to rely on more debt to finance its capital program. In the 2004 budget, as a one-time measure, the City diverted its Toronto Hydro income from a source of capital financing to an operating budget revenue which is not sustainable in the future.

Increasing cost and consumer demand pressures are being placed on the City's programs that cannot be offset by the City's own revenue generating capacity. Thus, the City will have to face significant program service adjustments unless a new financial deal from the other orders of government is forthcoming.