Office of the Provincial Controller Division

Accounting Issues Update

Briefing to Secretary of Cabinet

March 21, 2017

CONFIDENTIAL DRAFT– FOR DISCUSSION ONLY

Topics for Discussion

- Status of Key Accounting Issues
  1. Pension Accounting
  2. H1/OPG Consolidation
  3. BPS Line by Line Presentation
  4. Electricity Rate Mitigation
  5. Cap and Trade Accounting
  6. Accounting for Transit Assets
  7. Accounting for Transfer Payments
  8. Contaminated Sites
  9. Accounting for other GBE Transactions

Purpose

- To provide an update on key accounting issues with significant potential fiscal impact

Summary

	Issue	Fiscal impact in 2016-17	Reflected in Q3	Multi-year impact
1	Pension accounting – valuation allowances - Reversed FES treatment for OTPP/OPSEUPP - Panel recommendations on HOOPP, CAATPP TBD	$14.15M CAATPP $0 HOOPP	Yes	Yes
2	IFRS-US GAAP differences – OPG and H1 - Decision to adopt IFRS announced in Q3 - Public Accounts to reflect OPG 'preferred' approach	$0.1 B	Yes	Yes ($2.6B over 5 years)
3	BPS line-by-line consolidation	No	No	No-fiscal impact
4	Electricity Rate Mitigation			
5	Cap & trade proceeds - Revenue from 1st auction to be reported in 17/18	$478 Million	Yes	No
6	Metrolinx MOU with City of Toronto	TBD	No	Yes
7	Year-end transfer payments (e.g. Affordability Fund, AI)	TBD	No	No
8	Contaminated sites – i. OAG follow-up audit, ii. New liabilities in 2016-17	$54.1M – TBD	$47.5M	Yes
9	Other GBE issues (H1 sale; unrealized gains/losses)	$538M (H1) $180M (BH)	2016 Budget amt (H1 only)	No

1. Pension Asset Accounting

- Fiscal impact originally included in FES **for valuation allowances** was based on AG's position ($2.2 Billion in 2016-17, higher amounts in out-years)
- Based on Panel recommendations on OTPP and OPSEUPP, the original provisions have been reversed
- Full valuation allowance for 16/17 ($0 HOOPP; $14.5M CAATPP) for 2016/17
- For PRRT, full valuation allowances for 2017-18 on HOOPP ($102M) and CAATPP ($25M)
- Panel's report on HOOPP and CAATPP expected by end of March (results TBD)
- Status:
  - OPCD provided updated estimates of pension liability and expense in February
  - Technical briefing on Panel's recommendations held February 13, 2017
  - AG briefing in response to Panel's report held February 16 confirms disagreement with conclusions
  - Awaiting AG draft audit planning report for 2016/17 Public Accounts Audit
  - External actuarial advisor engaged to complete valuation analysis – work to commence on OTPP and OPSEUPP

2. Consolidation reporting basis for Hydro One and Ontario Power Generation

(US GAAP vs. IFRS)

- FES reflected US GAAP based results for OPG and H1
- Q3 Announced adoption of IFRS based reporting for OPG and H1 effective with the 2016/17 Public Accounts
- AG notified prior to Q3 release
- The net impact of adopting IFRS (IFRS14) for the Public Accounts will reflect OPG’s preferred method of valuing its nuclear asset retirement obligation
- Status
  - Updated estimates of impacts to be received from OPG by end of March
  - OPCD working with OAG,OPG and H1 on supplementary audit requirements
  - OAG has confirmed that OPG’s supplementary information requirements can focus only on the ‘preferred method’ but continues to require that procedures be performed to statutory level of materiality that would be required if OPG”s f/s were being audited

3. Consolidation Presentation
(BPS Line by Line Reporting)

- AG preference for line by line consolidation of hospitals, school boards and colleges on statement of operations, as well as consolidation of Children's Aid Societies
- Fiscal impact of changes would be immaterial with no significant enhancement to transparency
- Change in presentation would impact key performance indicators (e.g. IOD, revenue/GDP)
- Status:
  - Hospitals, school boards and colleges to be implemented on line by line basis beginning with the 2016/17 Public Accounts, including 5-year historical trend analysis
  - Plans for change communicated to OAG
  - Formal communication to ministry stakeholders in process (HAS CINDY APPROVED?)
  - Impact of potential consolidation for CAS initiated; for consideration for future years

4. Electricity Rate Mitigation

- Accounting for Global Adjustment (GA) deferral mechanism and the Affordability Fund are particularly complex
- MOE, MOF/OFA, TBS, OPG, H1, IESO and external advisors have collaborated on transaction structures and fiscal implications over the past several weeks.
- Status of Affordability Fund structure and accounting more progress.
- Analysis of GA deferral mechanism continues as financing details evolve
- High audit risk re: intended accounting treatment, including:
  - AG acceptance of rate regulated accounting on IESO books being reflected on CFS
  - Potential challenge by AG to OPG's status as a GBE
- •Complexity of the structure and length of deferral/recovery increase risk and public perception of transparency
- If all requirements can be met, an accounting analysis is expected to support: (1) increase in provincial borrowing (2) no increase in net debt, and (3) no impact on annual surplus/deficit, but depending on funding to OPG/Trust from Province, an increase in interest on debt and an increase in income from OPG (to offset IOD increase) will result.
- Draft legislation and financing structure critical to informing accounting analysis
- IESO to modify basis of reporting for March 31, 2017 financial statements and obtain external accounting opinion supporting rate regulated accounting
- OPG to obtain external accounting opinion on accounting for OPG Trust as holder of deferred asset
- For Affordability Fund, Hydro One to obtain external accounting opinion on accounting for Trust
- Auditor General has requested briefing of Province's initiative, including intended fiscal impact

5. Cap and Trade Accounting
(for 1st Auction Proceeds)

- Accounting analysis on recognition of $478 M auction proceeds shared with OAG
- Revenue from first auction (March 22, 2017) to be reported in 2017-18 under both Province's and AG's accounting approach
- For future years, revenue expected to be reported in period when Province' transfers emission allowances to purchasers; no deferral
- Status:
  - AG and OPCD disagree on revenue recognition point; however, difference would have no impact on the 2016/17 Public Accounts as it would be recognized in 2017/18 under either approach

6. Accounting for Transit Assets
(Metrolinx MOU with City of Toronto)

- FES reflects assets will be Provincially controlled (TCA, depreciation impacts vs. transfer payments)
- Accounting risk – if assets assessed as **not being controlled by the Province**, assets would be written off of Province's balance sheet and considered transfers to the City of Toronto
- Status:
  - OPCD stakeholdering with Metrolinx and MTO occurred in early 2017
  - Discussions expanded to also include PwC (Metrolinx's external auditor)
  - Metrolinx responsibility to identify potential accounting risks clarified
  - Metrolinx has engaged PwC to issue an accounting opinion based on binding Agreement in Principle between Province and City that is expected to be signed before year-end

7. Accounting for Transfer Payments
(year-end transfers)

TBS

- Audit issues during 2015-16 Public Accounts reversed planned accounting for Green Investment Fund expenditures ($325M)
- Expenses originally planned to be reported in 2015-16 for GIF are to be reported in 2016-17 (reflected in FES)
- Status:
  - OPCD/OAG discussions occurred to confirm details of accounting treatment; documentation exchanged to confirm application of accounting standards
  - Updates on 2015-16 experience provided to financial community (FCC, FBMC)
  - Updated guidance posted on Sharepoint

8. Contaminated Sites

i. **AG Follow-up audit on VFM audit for contaminated sites**
   - OPCD, OIAD and ministries collaborated on updated status of responses to VFM recommendations
   - OIAD also engaged to undertake review of contaminated sites accruals in advance of OAG fieldwork; steps being taken to optimize OAG reliance on OIAD work

ii. **New contaminated sites for 16/17**
   - Additional liabilities of approx. $100M identified in 2016-17 (estimate in process of being refined)
   - Grassy Narrows a potential liability based on actions taken by government (constructive obligation). Accounting and estimate TBD. (SEE NELSON)

9. Accounting for Other GBE Transactions (H1 Sale, Brampton Hydro Sale, etc.)

- For Public Accounts, ~~assumed~~ OPCD will continue to consolidate Hydro One HoldCo as a GBE. OPCD reviewed accounting with external advisors and accounting treatment is consistent with several precedents in the municipal sector. However, PSAB's Accounting Discussion Group continues to discuss HoldCo accounting. OPCD will continue to monitor.
- Gain from second tranche of Hydro One sale to be recognized in 16/17, excluding gain on sale of shares to OPG (related party) which will be deferred.
- Accounting analysis for Brampton Hydro sale being drafted by OPCD (est. gain $180M) in 16/17 to be shared with the OAG.
- Status:
  - OPCD analysis of various energy sector transactions shared with OAG as complete, including review by external advisors.
  - Control analysis on Hydro One HoldCo to be undertaken when Province anticipates additional dispositions.