TBS

Office of the Provincial Controller Division

Accounting Updates

Briefing for the Secretary of Cabinet

April 11, 2018

CONFIDENTIAL DRAFT FOR APRIL 6 DEPUTY MINISTER PRE-BRIEF
FOR DISCUSSION PURPOSES ONLY

Topics for Discussion

1. Accounting Issues Update
2. Fair Hydro Plan
3. Pre-Election Report
4. OPCD Internal Control Review
5. Other Updates

1. ACCOUNTING ISSUES UPDATE

Accounting Issues – Update

Items potentially affecting 2017-18 Surplus/Deficit

	Issue	Impact	Update	Impact to 2018-19 and out years
1	Indigenous Settlements/ Contingent liabilities	TBD (based on future assessment)	• Working group established to develop a framework to identify, assess and track OPS legal litigation/negotiation claims to support OPS financial reporting for likelihood/estimable • Analysis has been completed to assess the impact on the interim numbers - no provision recorded. Ministries (MAG, MIRR & MNRF) will continue to assess the likelihood/impact of the contingent liabilities during subsequent event period.	• Yes – TBD (contingent liability framework to be implemented)
2	OPG & H1 - H1 – Control Assessment - H1 – OEB Appeal - OPG – Asset Retirement Obligations	No change in 2017-18 resulting from control assessment ~$440M lower revenue if H1 records provision Reduced expense - $100M lower for 2017-18 & 2018-19; $225M lower in 2019-20 (booked in interim)	• Hydro One control assessment with ownership <50% determined H1 is controlled for 2017-18; 2018-19 at risk and reassessment will be performed with ownership further reduced resulting from Avista transaction; OAG review outstanding • OEB ruling in Sept 2017 that deferred tax asset resulting from transition from PILs to corp tax should not entirely accrue to shareholders – potential reduction in income is estimated up to $885M (approx. ½ attributed to the province); appeal heard December 19; H1 management expects ruling in its favour (note 12 of H1 Annual Report); • OPG has provided updates for ARO; declining discount rates based on 15 year rolling average; lower ARO estimates due to extended useful life of Pickering units	• Yes – impact if H1 not assessed as controlled; reduced income of $75M -$175M assuming current dividend • Yes – if not ruled before release of 2017-18, one-time adjustment based on outcome of appeal • Yes – updated annually
3	Accruals for negotiated compensation	$50M (MOHLTC) (booked in interim)	• MAG/MCSCS did not report any accrual for retroactivity of any future settlements on expired contracts relating to 2017-18; OPCD to consult ministries to estimate impacts • MOHLTC (OMA) accrued $50M for 2017-18 in accordance with the 2.6% TB mandate relating to year-over-year growth in the physician services allocation; binding arbitration process in late 2018 if no negotiated agreement reached	• Yes –final settlement will be reported

Accounting Issues – Update

Items potentially affecting 2017-18 Surplus/Deficit

	Issue	Potential Impact	Update	Impact to 2018-19 and out years
4	Drug rebates (MOHLTC)	~$345M (revenue - prior year recovery) (booked in interim)	• Correction of cutoff error identified in 16-17 audit (3 month lag); pickup of extra quarter of rebates ($259M for MOHLTC; $86M for MCYS)	• No – one-time correction
5	Non-resident Speculation Tax	$194M Interim estimate (booked)	• Position paper drafted supporting recognition of NRST when collected with a provision for rebates to be paid based on actual data and reasonable estimates; awaiting OAGO confirmation	• Yes – refunds to be estimated once more experience gained (OEP)
6	Waterfront Toronto	~$24M (Phase 1 only) (booked in interim)	• Accounting model finalized for Phase 2 of WT to report as transfer payment to City of Toronto (no provincial interest). • Additional expense offset from BCF	• Phase 1: ~ $13M • Phase 2: ~ $400M (managed within)
7	Remedy	$150M lower expense (booked in interim)	• Matter not settled at mediation –judicial direction to parties to negotiate resulted in lowering the estimate based on the likelihood of ETFO application; subsequently, ETFO pulled out of the remedy talks and decided to return to court raising uncertainty as to whether the lower estimate will be achieved.	• Potential – if final settlements paid differ from remaining accrual

Accounting Issues – Update

Items potentially affecting 2017-18 Surplus/Deficit

	Issue	Potential Impact	Update	Impact to 2018-19 and out years
8	GGRA transfer payment agreements	• TBD	• As part of supporting ministries in managing accounting risks related to the Greenhouse Gas Reduction Account (GGRA) programs, OPCD conducted a review of TP agreements for MAESD, MOECC, MHO and MTO to ensure any anticipated year end accruals reflect the terms of the TP agreement and PSAS. • Based on the review of the agreements, TB/MBC submission and associated TB/MBC assessment note, OPCD does not oppose the accounting treatment for MAESD and MTO. However, there are certain clauses / language in the MHO and MOECC agreements for which the current accounting treatment can be challenged. OPCD is working with MHO and MOECC to better understand their accounting treatment and to identify potential accounting risk associated with these agreements.	• Potential impact is criteria to recognize expense in 17-18 not met
9	Six Nations Agreement	• $102M	• The agreement is structured as a settlement and therefore the full value of the agreement must be accounted for in the fiscal year in which the negotiations occurred and the amount of the agreement can be quantified	• No – one-time impact
10	Non tax revenue	~$100M higher revenue	• Will correct cut-off error from 2016-17 and adjust 2017-18 revenue to March 31 based on other tax revenue subsequent receipts (e.g. EHT); historically, the difference from the estimate has not been adjusted	• No – one-time impact

Accounting Issues – Update

Items affecting 2018-19 and beyond

	Issue	Update
1	Northern Grid (Watay)	• Assessment of any potential risk on loan default will result in loan provision to be reported, as well as any amounts guaranteed under the Aboriginal Loan Guarantee Program for FN equity investment • Province is assuming construction risk throughout project through specific milestones related to community connectivity; need to assess annually for potential loss provision
2	Pension Updates	• Updates based on actuarial data from plans: $32M in 2018-19; ($162M) in 2019-20; ($388M) in 2020-21; ($353M) in 2021-22; the lower expense is due to higher than expected investment returns and lowering of the salary escalation expectation
3	Transit Infrastructure	• City of Toronto and Metrolinx Agreement-in-Principle signed for LRT/RER • OPCD will be engaging external advisor to support development of a framework to support determination of ownership for regional transit projects; MTO and Metrolinx are supporting these efforts
4	Ontario Cannabis Retail Corporation	• Based on the accounting analysis performed, the entity will be recognized as a Government Business Enterprise for financial reporting purposes. • Investments in Government Business Enterprises are included in the government's consolidated financial statements using the modified equity method (one-line consolidation with additional disclosure in Schedule 9). • Incurred a net loss of $8M in 2017-18 due to the initial start-up costs of establishing the corporation and its retail network.
5	Accounting for pre-2008 tax appeals	• OPCD discussed with MOF on accounting for tax appeals and whether accruals as a contingent liability is appropriate – information from CRA not currently available to determine reasonable estimate, but potential enhancement to contingent liability disclosure to be explored further for possible recommendation

Accounting Issues

- Indigenous Settlements
  - Process underway with MAG/MIRR regarding development of a principled framework for risk assessment and cost measurement for on-going litigated and negotiated events that may impact the current practice for recording contingent liabilities in the financial results.
    - Quarterly updates with mandates > $20M to be brought to TB for approval
    - Establish consistency and rigour to evaluation of contingent liabilities; framework presentation to Provincial Controller/DMs planned for April 2018
  - Reviewing negotiating mandates being brought to Treasury Board to ensure fiscal impacts, timing and risks are applied consistently (e.g. flooding easements, land claim valuation)

- Hydro One / Ontario Power Generation
  - OEB decision pending with possible negative impact to results for Hydro One re: deferred tax assets resulting from PILs exit (impact to Province ~$440M)
    - Appeal heard February 12; assuming the OEB applies rate making principles consistently with past practice management views it likely the motion will be granted and there will be no impact
    - no timeframe for ruling – 2017-18 impact if not successful and ruling before PA release
  - KPMG has supported the control assessment of H1 under PS1300 at less than 50% ownership; increased risk of portfolio investment accounting in 2018-19 after Avista issue with lowering stake ~ 42%; will be revisited annually
  - OPG has completed its annual exercise to update estimated cost of asset retirement obligation; lower costs compared to 17-18 due to extended useful life of Pickering units

	2017-18	2018-19	2019-20	2020-21
ARO Obligation under IFRS ($M)	300	375	475	425
Discount Rate	4.1%	4.3%	3.9%	3.8%

Accounting Issues

- Watay/Northern Grid
  - A periodic assessment of risk of default on the loans to fund construction for the project will determine if an allowance is required
  - Province to guarantee a portion of borrowing for the capital contribution for First Nations through the Aboriginal Loan Guarantee Program
  - Loan repayments to be secured by federal transfers to Watay upon completion of key milestones ("substantial completion" – 8 communities; "completion" – full connectivity)
- Transit Infrastructure
  - OPCD will engage an external advisor to assist with the development of a framework which can be applied to assess control/recognition/measurement of transit projects in the context of PS3150 – Tangible Capital Assets based on governance structure and allocation of risks (capital and operating)
  - The OAG has identified accounting for transit infrastructure as a focus for the 2017-18 audit – OPCD awaiting documentation from Metrolinx re: AIP signed with City of Toronto in January 2018
- Ontario Cannabis Retail Corporation (OCRC)
  - In October 2017, Ministry of Finance (MOF) received TB/MBC approval to establish a non-share capital corporation that is a Crown agency, the OCRC..
  - Based on the accounting analysis performed, similar to LCBO, OCRC will be recognized as a Government Business Enterprise for financial reporting purposes. Government Business Enterprises carry on a business which sells goods and services and is self-sustaining from outside revenues; can be a participant in a lawsuit (sue or be sued) – consolidated on a one-line modified equity method.
  - Incurred a net loss of $8M in 2017-18 due to the initial start-up costs of establishing the corporation and its retail network.

Accounting Issues

- Compensation
  - Current negotiations with ALOC/OCAA (MAG) – expired June 30/17 and OPSEU Corrections Bargaining unit (MCSCS) – expired December 31/17; negotiations on-going
  - MOHLTC has a negotiating mandate for a contract starting April 1, 2017; no amounts related to negotiations were accrued in 2016-17
  - Reasonable estimates for amounts relating to a negotiated settlement involving 2017-18 should be accrued as a contingent liability (PS3300); MAG/MCSCS have indicated no accrual will be made for 2017-18; MOHLTC has accrued expense for 2017-18 to align with mandate of 2.6%

- Non-resident Speculation Tax
  - Tax applied on interest in specified residential properties for non-residents, subject to rebate eligibility under certain conditions
  - Criteria being evaluated under PSAS to determine the “taxable event” for recognition; initial determination that revenue should be recognized when collected on a net basis against assessment for rebates eligible for claim (actual claims or estimate)
  - Position paper shared with OAGO for comment/confirmation of recognition for 2017-18

2. FAIR HYDRO PLAN

Fair Hydro Plan

- Key agreements have been finalized to facilitate the issuance of the debt to the market and establish the terms of the provincial guarantee to fund the Global Adjustment; first issuance was made in February 2018
  - Agreements provide for OPG as the Financial Services Manager to retain independence on the individual debt issues while constrained within the Financing Plan that is submitted to the Minister of Energy
- Under IFRS10, the current agreements support accounting for the financing trust to be consolidated under OPG, and brought into the government financial statement on a one-line presentation for government business enterprises
- OPCD is finalizing a position paper which documents all the facts, considerations and professional judgments applied in arriving at the accounting for the FHP as it relates to the GA as a rate regulated asset under US GAAP, the consolidation of the trust, and the impact on the Province’s consolidated financial statements
  - Once finalized, this paper will be shared with the OAGO and the Chair and Director of the Public Sector Accounting Board

3. PRE-ELECTION REPORT

Pre-Election Report

- On March 22, 2018 OAGO provided TBS and MOF proposed terms of engagement for their review of the Pre-Election Report
  - Deputy Ministers of Finance and Treasury Board Secretariat will be required to sign an acknowledgement of management responsibilities and review criteria
- OAGO has indicated they intend to conduct their examination in accordance with Canadian Standards on Assurance Engagements (CSAE) 3001 – Direct Engagements
- TBS and MOF will provide OAGO comments to clarify the objectives and criteria of the engagement, which the AG will conclude against in her report on PER

4. OPCD INTERNAL CONTROL REVIEW

Current Situation

- In July OPCD issued a Request For Services to:
  1. Confirm the alignment of OPS Internal Control Framework with the COSO 2013 international standard, and;
  2. Review and assess OPCD controls over financial reporting processes including:
     - Certificate of Assurance
     - Consolidation activities
     - Pension reporting
     - Period Close processes
     - Post-Close activities
     - Provision of complex accounting advice.
- PwC has completed their assessment and have submitted their final report to OPCD.

Findings

1. Internal Control Framework Assessment
   - is based on widely adopted standards
   - has been thoroughly tested and widely understood
   - implementation plan is aggressive but OPCD has considered the need to maintain momentum and the size and complexity of the OPS
   - the inclusion of annual progress reports should help OPS manage timeline and assess if additional support is required
   - opportunity to continue building training programs to support knowledge and awareness

Findings

2. Review and assess OPCD controls over financial reporting
   - Documented business processes, risks and controls
   - Tested 41 identified controls
   - Overall found controls are in place to address key risks within the organization
   - Identified 21 improvement opportunities related to:
     - Providing additional review over control activity
     - Provide additional documentation to evidence presence of control activity
   - Identified one control not implemented effectively however noted that plans have been put in place to address this going forward.
   - Noted OPCD is addressing future process changes through identifying future control requirements (e.g. CHIRP implementation)

Next Steps

- Assess improvement opportunities
- Develop project plans and implement

5. OTHER UPDATES

Other Updates

- PSSD Automation
  - A portal/web based technology was utilized to enable accountable organizations to populate their employee records in one tool that provides automated data validation. This stream lines the whole manual process of submitting spread sheets requiring manual validation by both the ministries and OPCD
- Planning, Budgeting and Forecasting (PBF)
  - The PBF initiative will enable the integration of the Planning, Budgeting & Forecasting processes with in IFIS. The solution will capture the data once at the lowest level and provide the ability to roll-up, report and manage multiple structures required by the central agencies and ministries (Estimates, PRRT, Operational and Scenario Planning)
- CHIRP
  - Hyperion-based solution to automate and standardize the production of the consolidated financial statements
  - Completed testing phases, and will undergo an end-to-end test in September 2018 (recreate 2017-18 consolidated financial statements); system of record for 2018-19 PA
  - Ministry training and impact assessment process for those affected will be delivered over the summer months – in development
- Enterprise Risk Management
  - Scheduled update with Chair of Corporate Audit Committee Apr 5
  - ERM Executive training program scheduled May 8
- Finance Community Talent Management
  - Executive Development Committee presentation June 2018