TBS

Office of the Provincial Controller Division

Accounting Updates

Briefing for the Secretary of Cabinet

October 6, 2017

Confidential – For Internal Discussion Purposes Only

Topics for Discussion

1. Accounting Issues – 2016-17 Public Accounts
2. Transit Infrastructure
3. Accounting Risks – 2017-18
4. Audit Advisory Update

1. ACCOUNTING ISSUES – 2016-17 PUBLIC ACCOUNTS

Accounting Issues – Update

2016-17 Public Accounts

- Highlights of AG Audit Findings Report
  - Two qualifications in the audit opinion
    - Pension assets ($12.4 billion increase to net debt and accumulated deficit; $1.4 billion increase to deficit →$2.4 billion per AG)
      - Pension Panel identified as a “non-authoritative” source on PSAS application
    - IESO reporting of $1.6 billion market account assets and liabilities
      - no impact to annual deficit, net debt or accumulated deficit
  - Other matters paragraph in opinion – rate-regulated accounting not permitted under PSAS; future material misstatement resulting from “legislated accounting”; FSD&A does not reflect pension accounting or market accounts appropriately
  - Statement that combination of pension accounting, market accounts and rate regulated accounting may result in an adverse opinion

Accounting Issues – Update

2016-17 Public Accounts (continued)

- Highlights of AG Audit Findings Report
  - Accounting for Fair Hydro Plan
    - Alleges management ignored requests for information; letter to DM Angus referenced
    - “disconcerting” that accounting is legislated under *Fair Hydro Act*
    - Identifies that IESO adoption of rate-regulated accounting is directly related
    - Indicates that accounting “opinion shopping” from private-sector firms not appropriate
  - Summary of unadjusted differences (SUDs)
    - 15 items totaling $1.6 billion (including pensions) increase to deficit
      - $191 million (excluding pension) increase to deficit – in-year only
      - $136 million (excluding pension) decrease to deficit – including correction of prior year misstatements
    - Excluding pensions, SUDs within auditor performance materiality of $440 million
      - Reference to performance materiality new this year; prior year only referenced planning materiality (set at $670M this year)

Accounting Issues – Update

2016-17 Summary of Unadjusted Differences

Issue – Incr/(decr) to in-year deficit	Description
Unadjusted differences to which there was no dispute – ($10 million	- Subsequent year-end tax receipts (EHT, Gas, Tobacco, Fuel,etc.) – ($104 million) - Ontario Rebate for Electricity Consumers (OREC) over-accrual – ($29 million) - Ontario Works – late claims not accrued - $23 million - Drug rebate fiscalization – cutoff error (calendar versus fiscal year) - $100 million - Consolidation of CCACs/CAS' – opening balance sheet impact (no deficit impact)
Unadjusted differences to which there was a disagreement between the AG and government accountants: $201 million	
• **Corporate tax fiscalization - $94 million**	• AG suggests a Q4 estimate based on 25% of the calendar year • OEP supports using 33% based on analysis; varying corporate tax year-end
• **Algonquin land claim - $200 million**	• AG established probability of settlement based on a sample of past claims; assessed reasonable estimate is determinable from documents (Agreement in principle) • OPCD cited other jurisdiction (BC) accounting treatment; ratification is not determinable; reasonable estimate is not determinable (despite federal accrual)
• **Remedy – ($160 million)**	• AG determined that lowest of three scenarios presented be accepted (accrual too high) • EDU supports the current remedy accrual pending final ruling given ETFO is returning to course – may have impacts on other settlements
• **Grassy Narrows - $85 million**	• AG cites minister's June statement confirming responsibility at the fiscal year end • MOECC/OPCD view is that government did not accept responsibility at the year-end; the June announcement was a 2017-18 event
• **Early Years / Child Care program - $58 million**	• AG cites Mandate letter and Budget announcements as establishing an obligation for a program that operates under a TP agreement on a calendar year with municipalities • EDU provides support that program enhancements don't come into effect until funding is approved and TP agreements are signed (July 2017)
• **Employee Life and Health Trusts – ($52 million)**	• AG indicates that as some trusts were not established at year end, expense is disallowed • EDU emphasizes that the trust is a vehicle to satisfy an obligation to employees which existed at the year-end based on the agreement signed between EDU and the unions
• **IESO rate-regulated accounting – ($24 million)**	• AG indicates that rate-regulated accounting is not permitted under PSAS • IESO received an unqualified opinion for use of rate-regulated accounting under PSAS
• **Balance sheet classification of Ontario held debt**	• AG suggests that amounts held as part of the OFA's cash management strategy results in an overstatement in assets and liabilities – no deficit or net debt impact -- $8.8 billion

2. TRANSIT INFRASTRUCTURE

Project Ownership Considerations
(slide provided by MTO)

- Transit projects can either be owned by the province or by a municipality. Each ownership model brings with it different accounting and risk implications.

- **Provincially-owned projects:**
  - Province can amortize the costs over the life of the project, helping to reduce the immediate fiscal impact.
  - As owner of the project, the Province has control over decision-making.
  - The Province assumes all implementation and construction risks. These include: environmental risks, local community impacts, property acquisition, cost overruns and project delay.
  - As project owner the Province is also responsible for all operating, maintenance, lifecycle, insurance and other liability costs of a project.
    - It is important to note however that some or all of these costs can be sub-contracted back to the municipality.

- **Municipally-owned projects:**
  - Provincial contributions are made through Transfer Payment Agreements, which result in shorter-term fiscal pressures.
  - As a funding partner to a municipally-owned project, the Province does not have control / decision -making authority.
  - All implementation risks as described above are the ultimate responsibility of the municipal project owner, along with all operating, maintenance, lifecycle, insurance and other liability costs.

Overview of Projects *(slide provided by MTO)*

Project / Capital Budget	Ownership	Project Status	Considerations
Eglinton Crosstown LRT $5.3B (2010$)	Province Note: Finch W, Sheppard E LRTs also provincially owned	Under construction Finch W in procurement, Sheppard E to follow	• Delivered by Metrolinx and Infrastructure Ontario. • In service September 2021. • Per draft cost-sharing agreement, City required to cover operating, regular maintenance costs (~$2B over 30 years). • Province responsible for the lifecycle maintenance costs (~$700M over 30 years). • These terms also apply to Finch W and Sheppard E LRTs.
Scarborough Subway Extension $3.346B (YOE$)	Municipality	<5% design	• Provincial contribution to City of Toronto project capped at $1.48B (2010$). • Project scope and budget have undergone various revisions as design progresses. • Province has not received a project business case.
Relief Line South $6.8B (YOE$)	TBD	0-2% design	• May be challenge for Province to demonstrate ownership i.e., that project is separate and distinct from municipal transit operations (links to existing TTC subway system). • Particularly complex - tunneling downtown Toronto, other cost risks e.g., complexity of Gerrard/ Pape station construction beneath existing rail corridor. • City's initial operating cost estimate of over $6 billion 2031–2080 (Escalated $).

Yonge Subway Extension
 	
$5.6B (YOE$)
	TBD	1 – 15% design	• May be challenge for Province to demonstrate ownership i.e., that project is separate and distinct from municipal transit operations (extension of existing TTC subway line).
			• Crosses Toronto and York Region municipal boundary.
			• May 2017 Toronto City Council resolutions state:
			    • City/ TTC will own, operate, and maintain YSE, recognizing it is extension of Line 1, subject to cost-sharing agreements with York Region and/or Ontario
			    • City will not agree to YSE unless construction of Relief Line South fully funded with firm completion schedule.

Status of Accounting

- Agreement in Principle (AIP) with the City of Toronto ("City") in final stages (expecting to be signed in the near term)

- The determination of ownership of the various transit infrastructure projects is based upon where the risks and rewards associated with ownership reside

- Characteristics of an asset are:
  - Future economic benefit will result
  - Full control and access to the benefit
  - Event has already occurred

- For each transit project, access and control will be the main consideration to establish eligibility to capitalize an asset; the notion of control implies that benefits and risks associated with ownership are present (e.g.

- Under the AIP, all GO Regional Express Rail (RER) projects are deemed to be controlled by Metrolinx; LRT extension projects will be owned by the Province while operated by the TTC
  - City contributions relating to capital and incremental operating and maintenance costs; lifecycle costs funded by the Province
  - Includes Eglinton LRT extension and SmartTrack stations on GO RER

- Provincial contributions for the Scarborough subway extension do not currently reflect any risk transfer to Metrolinx; all associated ownership risks will reside with the City

3. OTHER ACCOUNTING ISSUES

Accounting Risks – 2017-18

- Hydro One – given the reduced ownership position, accounting for Hydro One as a government business organization is currently being assessed by KPMG
- Ontario Power Generation – as part of the translation from US GAAP to IFRS for government reporting, the discount rates used under IFRS result in an adjustment (increased expense) relating to asset retirement obligations reported
- Contingent liabilities – OPCD will work with MAG to review the accounting requirements under PS3300 (Contingent Liabilities) for assessment of litigations, including land settlement
- Currently engaged with MOECC re: English / Wabagoon River (Grassy Narrows) and the establishment of an $85M fund and the mechanism by which that financial structure will be reported in the fiscal plan

WATCHLIST

- Waterfront Toronto – validating the appropriateness of the current 3-way proportionate consolidation
- Ontario Child Benefit – MOF/MCYS determining a method of measuring outstanding unclaimed benefits and the required adjustment to a portion of the expired accrued liability that will result in a recovery

4. AUDIT ADVISORY UPDATE

Update: Advisory Audit Committee

1. Principles
   - Established by amendment to the Auditor General Act
     - Provide independent and qualified individuals opportunity to review AG's draft reports prior to public release
   - Composition and Tenure
     - Up to seven members appointed by Order in Council
     - Competitive selection process based on pre-defined competency framework
     - AG involved in selection process invited as member of selection panel

2. Implementation
   - Proposed legislation part of a new government mandate
   - Working on Cabinet submission and draft legislation
   - Seeking direction to proceed