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

1. 2016-17 PUBLIC ACCOUNTS AUDIT

2016-17 Public Accounts Audit

TBS

Highlights of AG Audit Findings Report

- Two qualifications in the audit opinion
- 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 in 2017-18
- Accounting for Fair Hydro Plan
  - Alleges management ignored requests for information; letter to DM Angus referenced
  - Indicates that accounting “opinion shopping” from private-sector firms not appropriate
- Summary of unadjusted differences (SUDs)
  - Disagreement with OAG on the majority of the items raised
  - OAG referenced performance materiality of $440 million in current year (only referred to planning materiality in prior year which was $670 in the current year) – could have an impact on amount of work completed by auditor (increased work) or on resolution of differences of view on issues

2016-17 OAG Summary of Unadjusted Differences

Issue – Incr/(decr) to in-year deficit	Description
Unadjusted differences agreed to by government accountants: $302 million increase to deficit	
Unadjusted differences to which there was no dispute – ($10 million)	- Updated information on PIT from July 2017 CRA data – $312 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 disagreed with by government accountants: $201 million increase to deficit	
• **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

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 <u>or</u> 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 re: AIP with City

- Agreement in Principle (AIP) with the City of Toronto ("City") in final stages (expecting to be signed in the near term)
- Metrolinx finance function has reviewed and has confirmed that LRTs will be accounted for as provincial assets
- External auditor for Metrolinx (PwC) has been engaged during the negotiation process and is reviewing the final draft of the contract
- PwC to confirm back whether they have discussed the issue with the OAG and/or whether they are planning to raise this contract with the OAG during the course of this year's audit
- OPCD will work with Metrolinx to ensure OAG receives the appropriate accounting analysis for this agreement

3. OTHER 2017-18 ACCOUNTING ISSUES

Accounting Risks – 2017-18

- Hydro One – OEB Transmission Decision released September 28, 2017 – OPCD is working with Hydro One to determine the accounting impact of the decision
- Hydro One – given the reduced ownership position, accounting for Hydro One as a controlled 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 relating to asset retirement obligations reported
- Contingent liabilities – OPCD is working with MAG to review the accounting requirements under PS3300 (Contingent Liabilities) for assessment of contingent liabilities, including land settlement claims

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