# 2016-17 Public Accounts

## Technical Briefing

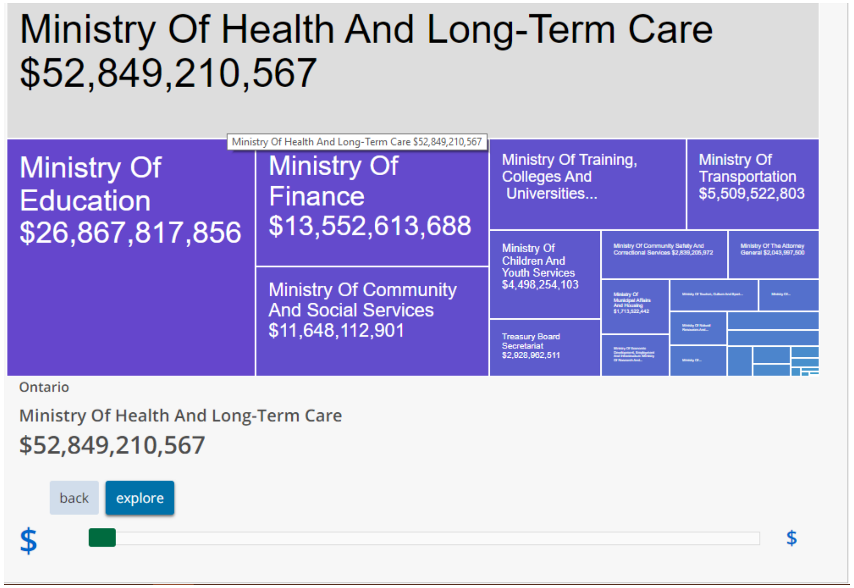
September 7, 2017

# Purpose of today's briefing

1. Provide an overview of the results for fiscal 2016-17
2. Highlight the changes made in the 2016-17 financial statements:
   a) Classification of third-party revenues for hospitals, colleges and school boards
   b) Accounting basis for Ontario Power Generation and Hydro One
   c) Accounting for the Independent Electricity System Operator (IESO) and market accounts
   d) Accounting for net pension assets of jointly sponsored pension plans

# 2016-17 Highlights

- New digital tools have been developed that present the Public Accounts data in innovative, visual formats.
- This year, Ontario has:
  - Released six new downloadable data sets
  - Created new data visualizations tools
  - Published the web page under the Open Ontario Licence



# 2016-17 Highlights

- Ontario has beaten its deficit target eight years in a row. The 2016-17 Public Accounts of Ontario show that Ontario’s deficit is $1 billion - $3.3 billion lower than projected in the 2016 Ontario Budget.

- In the 2016-17 fiscal year (April to March):
  - revenue was $140.7 billion – $2.2 billion more than expected in the 2016 Budget
  - expenses were $141.7 billion – $0.1 billion less than planned in the 2016 Budget
  - Some of the top spending areas included

$56B Health

$26.6B Education

$12.9B Infrastructure



Ontario

# 2016-17 Highlights

Other highlights include:

- Ontario’s real gross domestic product (GDP) was 2.7%, up from 2.2% in the 2016 Budget. Over the last three years, Ontario’s GDP growth has outpaced that of all G7 countries.

- Net debt-to-GDP continues to be forecasted lower than expected for 2016-17 at 37.8%, an improvement over the 2016 Budget of 39.6%.

Visit **Ontario.ca/publicaccounts** for more highlights and digital tools that help make Ontario’s finances easier to understand, access and use.

# Summary 2016-17 Results

| 2016-17 Actual Results | | | | | |
|---|---|---|---|---|---|
| **$ Billions** | **2016-17 Budget[1]** | **2016-17 Actual** | **2015-16 Actual [1 2]** | **Change from Budget** | **% Change** |
| **Revenues** | 138.5 | **140.7** | 136.1 | 2.2 | 1.6% |
| **Expenses** | 141.8 | **141.7** | 139.7 | (0.1) | -0.1% |
| Reserve | 1.0 | **-** | - | (1.0) | |
| **Annual Deficit** | (4.3) | **(1.0)** | (3.5) | 3.3 | -76.7% |
| **Net Debt** | | **(301.6)** | (295.4) | | |
| **Accumulated Deficit** | | **(193.5)** | (192.0) | | |

[1] 2015-16 Actuals and 2016-17 Budget have been reclassified to reflect the change in presentation for third party revenues of hospitals, colleges and school boards (no change to deficit)

[2] 2015-16 Actual has been restated to reverse the impact of regulated accounting for pensions



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# Preparation of the Financial Statements

- The consolidated financial statements are prepared by the Government of Ontario in accordance with the accounting principles for governments recommended by the Public Sector Accounting Board (PSAB).
- PSAB independently establishes accounting standards for the public sector in Canada.
- The objective of PSAB standards is to meet the needs of users of financial statements by providing the information needed for accountability and decision making.
- PSAB standards specify how transactions and other events are to be recognized, measured, presented and disclosed in a public sector entity's financial statements.
- PSAB recognizes that their standards cannot address every potential situation, and that it may be necessary to refer to other sources of guidance.
  - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances. (Section PS 1150.07 from the PSA Handbook)*



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# Accounting Changes for 2016-17

- The Province adopted several new accounting changes for the 2016-17 Public Accounts to better reflect the financial position and activities of the government during the fiscal year
- These changes included:
  a) Classification of third-party revenues for hospitals, colleges and school boards
  b) Accounting basis for Ontario Power Generation and Hydro One
  c) Accounting for the Independent Electricity System Operator (IESO) and market accounts
  d) Accounting for net pension assets of jointly sponsored pension plans



Ontario

# Classification of Third-Party Revenues for Hospitals, Colleges and School Boards

- 2016-17 Public Accounts present third-party revenues for hospitals, school boards and colleges with provincial revenue.
- In prior years, these revenues were netted against the expenses of the respective sectors (health, education, post-secondary).
- This is a change in presentation only.
- The changes increases total revenues and expenses by approximately $8 billion.
- There is no impact to the Province's deficit, net debt or accumulated deficit.
- This change is consistent with PSAB standards and the reporting practices of other senior Canadian governments.
- This change, supported by the Province's professional accounting staff, was recommended by the Office of the Auditor General in prior years.

# Accounting basis for Ontario Power Generation and Hydro One

- The 2016-17 Public Accounts include the financial results of Ontario Power Generation (OPG) and Hydro One using International Financial Reporting Standards (IFRS).
- These two government business enterprises currently report their stand-alone financial results using Generally Accepted Accounting Principles in the United States (US GAAP).
- In prior years, the reported results of OPG and Hydro One were included in the results of the Province based on US GAAP.
- This change does not have a material impact on this year's Public Accounts.
- This change, supported by the Province's professional accounting staff, was recommended by the Office of the Auditor General in prior years.

# Accounting for Independent Electricity System Operator (IESO) Market Accounts

- Independent Electricity System Operator (IESO) is a corporation established pursuant to Part II of the *Electricity Act, 1998*, and prepares its financial statements in accordance with PSAB standards.
- KPMG LLP audits IESO's financial statements and issued an unqualified opinion on the December 31, 2016 financial statements.
- IESO administers a $17 billion annual market reflecting the amounts *due to* entities that provide electricity to the market (e.g. power generators) and *due from* entities who consume electricity (e.g. local distribution companies on behalf of their consumers). IESO is a party to these agreements with the market participants.
- In 2016, IESO changed the accounting for the market accounts, recognizing these amounts due from and due to the market participants as assets and liabilities respectively.
- This change has no impact to the province's annual deficit, net debt or accumulated deficit.
- The Ontario Power Authority (which was merged with the IESO on January 1, 2015) included a segment of these accounts in its financial statements, and received an unqualified opinion by its external auditor, KPMG LLP. The financial statements of the Province were not qualified by the Office of the Auditor General as a result of including these accounts.

# Accounting for IESO Market Accounts

- The IESO is a party to agreements with each market participant, and each market participant either owes an amount to the IESO or is owed an amount from the IESO. For example:
  - Ontario Power Generation has a receivable from IESO recorded on its financial statements related to power generated, and historically, IESO did not have a payable recorded to Ontario Power Generation – now it does
  - Hydro One has a payable to IESO recorded on its financial statements related to power purchases, and historically, IESO did not have a receivable recorded from Hydro One – now it does
- The amounts due from market participants meet the definition of an asset and the amounts due to market participants meet the definition of a liability under PSAB standards.
- In connection with this change, the accounting for eight other independent system operators in North America were reviewed, and all but one recognize market accounts in the financial statements.
- IESO management, their Audit Committee, their Board of Directors, their external auditor and the Office of the Provincial Controller support the change in accounting as being more transparent.
- A qualified opinion was issued by the Office of the Auditor General on the 2016-17 consolidated financial statements regarding the change in Independent Electricity System Operator’s accounting for the “market accounts”.



Ontario

# Accounting for Net Pension Assets of Jointly Sponsored Pension Plans

- Ontario Public Service Employee's Union Pension Plan (OPSEUPP) and Ontario Teachers' Pension Plan (OTPP) are jointly sponsored pension plans (JSPPs) where the Government of Ontario is a co-sponsor.
- The plans are funded on a 50/50 basis, co-managed by the sponsors, and decisions regarding benefits and contributions require negotiation and agreement between them.
  - On June 12, 2017, the co-sponsors of OTPP (Ontario Teachers Federation and the Government) announced a 1.1% reduction in contributions effective January 1, 2018
- Under PSAB standards, an asset arises when the government's total contributions to a plan, including interest earned thereon, are greater than the pension expense recognized since the start of the plan.
- Since 2001-02, the Province's share of pension assets reflected on the audited consolidated financial statements of the Province has been based on a policy considered to be consistent with PSAB standards related to accounting for retirement benefits.  The standards have not changed since their issuance in 2001.
- In 2016, the government passed a time-limited regulation to require the full write-off of the net assets of both of these plans for the 2015-16 Public Accounts.



Ontario

# Pension Accounting

- Based on professional staff's interpretation of PSAB standards, the government believes that pension assets for OPSEUPP and OTPP should be reported to fairly present the Province's financial position.
- The Province has shared control over the pension plan and the existing agreements in place between the sponsors support the recognition of the pension asset.
- The professional staff does not believe that the Government has the right to withdraw any surplus from the plan, and has supported the value of the pension asset solely on the basis of being able to reduce contributions in the future.
- The Province has recorded the pension assets for OTPP and OPSEUPP in its 2016-17 consolidated financial statements and has restated the 2015-16 consolidated financial statements to recognize the pension assets.
- With respect to the Healthcare of Ontario Pension Plan (HOOPP) and Colleges of Applied Arts and Technology Pension Plan (CAATPP), based on the difference in governance structures between these plans and OTPP and OPSEUPP, the Province has recorded a valuation allowance for CAATPP in the year (amount is not material). The HOOPP plan is not in a net asset position for accounting purposes at March 31, 2017. This treatment is consistent with the recommendations of the Pension Asset Expert Advisory Panel who issued a supplementary report on these plans in March 2017.

# Pension Accounting

- The professional staff's interpretation of PSAB standards is supported by its own research and analysis as well as:
  - The report of the Pension Asset Expert Advisory Panel (https://www.ontario.ca/page/pension-asset-expert-advisory-panel-report) released on February 13, 2017 stating that the Government should record an asset for its share of the surplus reported in the accounting valuations for each plan and that no valuation allowance is required.
  - An opinion from Deloitte LLP on aspects of the Province's accounting as at March 31, 2016 for the OTPP, a summary of which is included in Appendix A. The opinion, which was dated October 2, 2016, concluded that it was permissible to recognize a pension asset under Canadian Public Sector Accounting Standards, even though the Province did not have under a unilateral right to reduce contributions.
  - Analysis completed by EY as to whether any valuation allowance is required to be recorded for OTPP or OPSEUPP as of March 31, 2017. EY confirmed no valuation allowance was required for either plan.
- A qualified opinion was issued by the Office of the Auditor General on the 2016-17 consolidated financial statements regarding the Province's accounting for the net pension assets of OTPP and OPSEUPP.

# Appendix A – Deloitte Summary of Accounting Opinion Issued on Pension Accounting

Deloitte was engaged to provide a report ("Deloitte Report") on the application of accounting standards by the Ontario Treasury Board Secretariat. Our report, which was issued on October 2, 2016, was prepared under professional standards for such reports set out by CPA Canada.

The subject of this report was the application of Public Sector Accounting Standards (PSAS), as established by CPA Canada, in the recognition of a pension asset in the Province of Ontario's financial statements. Pension accounting is subject to professional judgement and interpretation, and involves significant accounting estimates. The Deloitte Report focused on a specific aspect of this complex area as it relates to the Province of Ontario's accounting for the Ontario Teachers' Pension Plan (OTPP).

OTPP is a pension plan that is jointly sponsored by the Ontario government (or the Province) and the Ontario Teachers' Federation (OTF). Based on the Province's application of PSAS, OTPP is in a plan surplus position. We accepted this aspect of the Province's application of PSAS as a matter of fact in developing our report.

The Deloitte Report addressed the question of whether it was possible to record a pension asset related to the plan surplus in the Province's financial statements, given that the plan is jointly sponsored. We concluded that, based on the information provided to us by the Province and our professional judgement, that it was permissible under PSAS to record a pension plan asset, even though the Province's ability to benefit from any plan surplus, through future contribution reductions for example, would need to be negotiated with and agreed between the Province and OTF.

It is to be noted that even if a pension asset is recorded, PSAS would also require that consideration should be given to limiting the recorded amount of this pension asset to an amount that would be less than the calculated amount of the pension surplus. The Deloitte Report did not express a view on whether any limit to the recorded amount of the asset is needed in the case of the Province's accounting for the pension asset related to OTPP. Therefore, our report did not express a view on the amount of the pension asset that should be recorded in the Province's financial statements as at March 31, 2016 or at any other date.

# Appendix B: Panel Members

- Patricia O’Malley (Chair) – former Chair of Canadian Accounting Standards Board, former member of International Accounting Standards Board, Chair of the Canadian Actuarial Standards Oversight Council, former technical partner KPMG

- Murray Gold – Leading practitioner and senior pension and benefits partner at Koskie Minsky LLP

- Uros Karadzic – Pension actuary, member of the PSAB’s Employment Benefit Taskforce, partner at EY

- Paul Martin – Comptroller with the Government of New Brunswick, member of the PSAB’s Employment Benefit Taskforce and previously a partner with the national accounting firm of Grant Thornton LLP

# Summary of Pension Asset Expert Advisory Panel

Technical Briefing

September 7, 2017

# Pension Asset Expert Advisory Panel -- Process

- Panel was provided with briefings and documents (relevant legislation, plan texts, sponsor agreements) to assist members to fully understand the facts and circumstances of the Plans and the basis for the government's accounting conclusions.

- Panel met with the Auditor General and members of her team to fully understand the basis for the OAG's accounting conclusions.

- Panel performed its own independent analysis of those documents and the legal, actuarial and accounting issues and reached its own conclusions.

- Panel considered:
  - guidance in PSAS specifically on Retirement Benefits
  - other relevant guidance in PSAS, and that issued by other standard setters identified in PSAS as sources to consult, in areas where the retirement benefits standard is not clear

# Panel’s Position on Recognition of Asset

- Net pension asset meets the definition of an economic resource because:
  - accounting surplus exists, and
  - future economic benefit is available to government as contribution reductions, freeing cash for other purposes.

- Unilateral control not necessary for asset recognition:
  - in fact, cannot exist in JDBPs or any other jointly controlled arrangement
  - sponsors jointly control the total net pension asset and must agree on how it will be used
  - key notion with joint control is that each sponsor can deny the other sponsor(s) access to the asset, ensuring no one side can make unilateral decisions
  - each sponsor should then recognize an asset relating to its portion of that jointly controlled surplus.

# Panel’s Position on Measurement of Asset

- Retirement benefits standard states that a sponsor measures the benefit of a surplus by the extent to which it can either take assets out of plan or reduce future contributions

- Contribution reductions are not the same as surplus withdrawal:
  - legal requirements for surplus withdrawal and contribution reductions are very different
  - joint sponsors free to decide on level of contributions in compliance with terms of Plan and Pension Benefits Act
  - no third-party approvals needed for contribution reductions

- No requirement for any agreement to be in place specifying exactly when and by how much contributions will be reduced
  - agreements in place already sufficient
  - standard says benefits need only be reasonably expected

- No onerous funding requirements exist for OTPP or OPSEUPP

# Overall Conclusions of Panel

Recognition and measurement of the asset

- Net pension asset, without any valuation allowance, should be recognized in the Province's financial statements.
- Recognizing the asset will provide a faithful representation of the Province's financial position.
- Recognizing the asset will properly reflect the intention of the "deal" between the sponsors.

Overall

- Reasonable expectation that Sponsors will be able to benefit from lower contribution levels in future
- Established mechanisms exists to put these expectations into practice (in Plan documents and legislation)
- Surplus assets have real economic value government can benefit from so should be recognized

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