Office of the Provincial Controller Division

Key Accounting Risks
Fiscal Update Deck

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Key Accounting Risks: Considerations

- Known upcoming accounting issues include:
  - reporting of net pension assets,
  - basis of consolidation for OPG and Hydro One and
  - developments regarding contaminated sites liabilities.

- In addition, the timing of recognition of cap-and-trade auction proceeds affects the trajectory for revenues, and decisions on associated matching program expense.

- The FES fiscal plan included a cautious approach that all net pension assets would not be reported by the Province in future and a status quo approach for the other expense items, based on information available at the time.

- Forecasted amounts for these risks are subject to change, as they will be updated in the current year. New information for pensions is expected in mid-February 2017 and for OPG and Hydro One at the end of February 2017.

- The total estimated fiscal impacts to the FES plan from the preferred approach to the accounting risks are ($2.8B) savings in 2017-18 as compared to FES.

Key Accounting Risks

Fiscal Impact Overview

	Issue	Fiscal Impact to FES					Details
		2016-17	2017-18	2018-19	2019-20	2020-21*	REF
1	Reporting of Net Pension Assets A - Current AG's position B - Expert Panel Position (Estimates to be updated in early February, 2017)	- ($ 2.2B)	- ($2.7B)	- ($3.1B)	- ($3.1B)	- ($3.1B)	Slide 4
2	Basis of Consolidation of OPG and H1 (US GAAP vs. IFRS) A - Current FES - qualified opinion B - Preferred Approach (smoothed IFRS impact)* C - High Impact (non-smoothed IFRS impact)** ** OPG estimate of cumulative impact for 2015-2020 $2.5B* ***OPG estimate of cumulative impact for 2015-2020 $2.6B*	- $75 M $1B	- $425M $375M	- $525M $400M	- $675M $400M	- $675M $400M	Slides 5 & 6
3	Contaminated sites liabilities Estimated impact Essar, Stelco and MNDM related liabilities	$50M	-	NA	NA	NA	Slide 7 & 8
4	Cap and Trade Proceeds (does not include reduction in amount estimated by MOF)	$478M	($478M)	-	-	-	Slide 9
	Total fiscal (savings)/pressure **Preferred Approach** **High impact approach**	**($1.6B)** **$1.5B**	**($2.8B)** **($0.1B)**	**($2.6B)** **$0.4B**	**($2.4B)** **$0.4B**	**($2.4B)** **$0.4B**	

*** 2020-21 numbers are not available at this time and have been projected as being consistent with 2019-20.**

Reporting of Net Pension Assets

($ Millions)	2016-17	2017-18	2018-19	2019-20	2020-21	Assumptions
Current FES: Regulated accounting used in Public Accounts	-	-	-	-	-	• No pension assets should be reported for OTPP or OPSEUPP • AG's position on HOOPP and CAATPP has not been communicated, but assumed consistent for this purpose • Regulation on accounting to support signoff on the Financial Statements would be required. • AG would qualify her opinion due to use of regulation
Preferred Approach- Expert Advisory Panel position	($2.2B)	($2.7B)	($3.1B)	($3.1B)	($3.1B)	• Expert Advisory Panel (EAP) agrees with the Province`s position to recognize pension assets for joint sponsored plans (OTPP and OPSEU) • Expect EAP to recommend that pension assets for HOOPP and CAATPP should not be reported under PSAS • If AG does not agree with Province (and Panel) audit report will be qualified.

Note: All Numbers are based on 2016 budget and estimates to be updated in early February, 2017 pending receipt of actuarial assessments

OPG/H1 Consolidation – (US GAAP/IFRS)

- US GAAP based reporting is accepted by Canadian Securities Regulators and rate regulators, including the Ontario Energy Board. Rate regulated entities including Hydro One and Ontario Power Generation, Enbridge, Union Gas, TransCanada Pipelines, report based on US GAAP and receive clean audit opinions.
- Hydro One can use US GAAP indefinitely based on securities regulations. OPG can use US GAAP based on securities regulations until at least January 1, 2019 in light of on-going deliberations under IFRS in relation to rate regulated accounting.
- PSAS does not acknowledge the use of US GAAP as a basis for reporting in the consolidated financial statements of the province – it only acknowledges International Financial Reporting Standards (IFRS).
- In 2015-16, the Province consolidated H1 or OPG using US GAAP. The differences between US GAAP and IFRS were immaterial.
- Reporting H1 and OPG results on an IFRS basis would have a significant impact in 2016-17 and beyond, mainly due to differences in the accounting treatment for OPG's nuclear related asset retirement obligation.
- Potential IFRS vs. US GAAP differences could increase materially if rate regulated accounting is rejected under IFRS (decision could take several years).

IFRS vs. US GAAP for consolidation of H1 and OPG

($ Millions)	2016-17	2017-18	2018-19	2019-20	2020-21	Assumptions
Current approach – Qualified Opinion	-	-	-	-	-	• Status Quo: Province continues to consolidate H1 and OPG on US GAAP basis (same basis as used GBEs) • Province adjusts statutory framework to support this accounting policy decision, including passing any needed FAA regulation • AG qualifies her audit opinion
Preferred Approach (smoothed IFRS impact) **Adopt IFRS for Public Accounts with annual update to ARO discount rate***	$75M	$425M	$525M	$675M	$675M	• Province consolidates OPG and H1 results as calculated under IFRS reflecting annual updates to the discount rate applied to calculate OPG's asset retirement obligation • The year over year change is higher than alternative below due to change in annual discount rate • If AG agrees with the Province's preferred annual update approach – unqualified opinion • Province would accept risk of potential future elimination of rate regulated accounting under IFRS standards (potential write-off of $9 billion in regulatory assets, introduction of volatility to annual surplus/deficit – decision not expected to be known for several years)
High impact (not smoothed): **Adopt IFRS for Public Accounts (5 year update to ARO discount rate) **** **Method used by AG to determine error.**	$1B	$375M	$400M	$400M	$400M	• Province consolidates OPG and H1 results as calculated under IFRS reflecting updates to the discount rate for OPG's nuclear-related asset retirement obligations only every five years (in the year of an ONFA update) • The year over year change is lower than alternative above due to same discount rate over the 5 years under this approach • Province would accept AG's view regarding frequency of ARO discount rate update (inconsistent with OPG's updated estimate approach and preference for annual updates) • Province would accept risk of potential future elimination of rate regulated accounting under IFRS standards (write-off of $9 billion in regulatory assets, introduction of volatility to annual surplus/deficit – decision not expected to be known for several years)

** OPG estimate of cumulative impact for 2015-2020 $2.5B*
***OPG estimate of cumulative impact for 2015-2020 $2.6B*

Contaminated Sites Liabilities: Considerations

- In February 2015, TB/MBC approved the adoption of a new Public Sector Accounting Board (PSAB) standard related to liabilities for environmental remediation of contaminated sites. Related amendments to the Financial Administration Act were brought into force in the spring of 2015.
- Ministries reported their existing known environmental liabilities in the 2015-16 PRRT process and a total liability of $1.7B was booked in the 2014-15 Public Accounts. Remediation costs for these sites that were included in the initial estimate of the liability can be incurred without further fiscal impact.
- Further increments to amounts for existing sites, and any amounts for new sites, require recognizing the expense and related at the time it is known and estimable.
- Fiscal impacts noted for the items on the following slide reflect only the contaminated site expense exposure, and do not reflect other potential fiscal impacts of the related transactions.

Contaminated Sites

($ Millions)	2016-17	Assumptions
Essar Steel	$50M	• Contingent on court ruling (expected in January 2017) which may provide approval for a restructuring proposal for Essar Steel. Anticipated proposal would result in the Province being the only party available to take responsibility to address contamination. • Potential exposure relates to a high risk Essar Steel site (from a health and safety point of view) with contaminating groundwater, and a water treatment plant which is partially built.
Stelco	$0	• Negotiations currently underway with parties including U.S. Steel Canada (USSC) including the approach for USSC contaminated land in Hamilton. Current proposal would involve Province assuming an $80M legacy obligation regarding the contaminated site, as well as an offsetting payment of $80M. • Risk that if negotiations unsuccessful, the land may be abandoned, leaving the Province to assume the entire responsibility for remediation (potentially significantly more than $80M), with no offset. • Timing of potential agreement (TBC – likely 2016-17)
MNDM New Contaminated Site Liability	Unknown could be $50M -$100M	• MNDM is expecting a site assessment to be completed on a potentially contaminated site which is as high risk (to confirm whether a material amount of remediation required).
Contaminated Sites (general)	TBD	• AG will be conducting a follow-up audit on contaminated sites during the 2016/17 Public Accounts audit which may result in additional accounting and/or audit risk related to liability recognition and measurement.

Accounting for Cap and Trade Revenues: Considerations

- Accounting advice is being developed, and confirmed with the Auditor General, as to at what point in the business process of cap and trade auctions the Province should recognize the revenue from the auction. Likely outcome is revenues will have been earned once the allowances have been provided to the auction participants.
- Current planned date of first auction (March 22, 2017) would lead to 2017-18 as the year in which those revenues can be booked as the allowances are not transferred to the participants until 2017-18. FES fiscal plan had assumed revenues booked in 2016-17, when the auction was held and all bids registered.
- MOECC has added additional caution as to possible participation in the auctions, which has reduced the revenue forecast for each auction from the FES fiscal plan. This change is not reflected as part of the accounting risk.

Other Relevant Accounting Issues

1. Accounting implications of Metrolinx agreement with City of Toronto
   - Risk: If control criteria not met for accounting purposes, Province will have to write off capitalized costs (immediate expense impact), and future investments/transfers will be accounted for as expenses
2. Accounting for various electricity sector transactions (H1 shares, Brampton Hydro)
3. 2016-17 Transfer payment expense recognition (timing)
   - Risk: Status of transfer payment agreements and timing of cash flows related to year-end TPs expected to impact timing of expense recognition