Media Event: Auditor General's Review of the Pre-Election Report on Ontario's Finances

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MEDIA EVENT: AUDITOR GENERAL'S REVIEW OF THE PRE-ELECTION REPORT ON ONTARIO'S FINANCES
April 25, 2018

Time / Location:
12:00 p.m. / Queen's Park Media Studio

Speakers:
Bonnie Lysyk, Auditor General of Ontario.

Media Attendance:
Print – 8
TV – 5
Radio – 1

Media Outlets:
Jeffords – CP; Benzie – Star; Blackwell – Post; Artuso – Sun; Smith Cross – QP Briefing; Reeves – QP Today; Crawley - CBC Radio/TV; Brule - Radio Canada/CJBC; Morris – Newstalk 1010; Rath - CHCH Television; Tumelty - City TV; Mulligan – City; Morissette – TFO; McGrath – TVO;

Statement:
Hello everyone, I'm Bonnie Lysyk Auditor General of Ontario and I want to thank you for the opportunity to speak with you about our review of the government's 2018 Pre-Election Report on government finances – on Ontario's finances. I'd like to begin by explaining why we're here today. The Fiscal Transparency and Accountability Act says that in a fixed election year the government must provide a report on the province's finances. This Pre-Election Report must include projections for the current budget year and for the two years following. The same act requires my office, an independent office of the Legislative Assembly, to review the government's report to determine whether it is reasonable. Today we fulfil this legislative requirement. After a thorough analysis we have determined that the Pre-Election Report is not a reasonable presentation of Ontario's finances. We say this because it dramatically understates the expense estimates for two major items. These lower estimates lead to the provinces forecasted annual deficits being understated by billions of dollars, for the current budget year and the two following years. We have determined that after adjusting for the understated expenses, the deficit for 2018-19 should be forecast as 11.7 billion, or 75 percent more than the 6.7 billion presented by government. In 2019-20 which should be forecasted as 12.2 billion, or 85 percent more than the presented 6.6 billion, and in 2020-21, 12.5 billion, or almost double the presented 6.5 billion. The consequences of these major differences

between the government's projections and the likely actual deficits are significant. For example, they create the perception that the government has more money available to it than it actually does. This could lead decision makers to allocate money to initiatives and programs when that money is in fact needed to pay for expenses that were not properly recorded. These understated numbers also suggest that the government's debt picture is better than it is. In fact, the burden of net debt is actually rising more than the government is presenting in the Pre-Election Report. I referred earlier to two major items that led to these incorrect deficit projections. The first is that the government did not properly reflect in the Pre-Election Report the true financial impact of the electricity rate reduction resulting from its Fair Hydro Plan. The plan gives ratepayers a discount on their hydro bills, but someone else still has to compensate power generators for the reduced revenues resulting from the discount. That someone is the government and it must borrow to pay this compensation. However, the government did not include the cost of compensating the power generators or the interest on the money borrowed to pay that compensation in its forecasted expenses. The second major item relates to two jointly sponsored pension plans for public employees. The government forecasts pension revenue from the Ontario Teacher's Pension Plan and forecasts insufficient pension expense from the Ontario Public Services Employee's Union Pension Plan. This has reduced on paper the government's overall pension expense, however the government should not have done this because it has no unilateral legal right to use its share of any plan surpluses without first reaching a formal agreement with the plans other joint sponsors. To date it has not announced any such agreements. In fact, it continues to contribute approximately two billion annually to those pension plans. By excluding expenses that result from government decisions, the Pre-Election Report does not provide Ontarians with a clear picture of Ontario finances needed for true transparency. The fiscal transparency and accountability act requires the government fiscal policy should be based on cautious assumptions. Now, with the exception of the two items just discussed, we generally found that the government's estimates of revenues, program expenses and interest on debt were based on cautious assumptions as required by the act. It should be noted that financial results for the three years in question will likely differ from the estimates. Not just because of the understated expenses, but because future events are not certain and can have unpredictable impacts. Now I'd be happy to answer your questions.

<u>**Media Questions:**</u>
Q. Smith Cross: Is this a qualified opinion?

On this we're required to say whether or not the Pre-Election Report is reasonable and we're saying it's not reasonable. The qualification comes about when we actually audit the historic results for a year. So we haven't audited the financial results for 17-18 and at that point we'll be assessing what the impact is on the 17-18 financial statements to determine what type of an opinion we issue.

Q. Benzie: Bonnie, have you received assurances from the other two political parties that they are going to adopt the same accounting and they're not going to count the pension assets? I mean, we know that the NDP is going to cancel the Fair Hydro Plan. The Tories I think were going to keep it in the 'People's Guarantee,' it's not clear what they're going to do moving forward when they do release their platform on that front, but are you on the pension asset stuff, are you hopeful that they will adopt your standard?

Yeah I haven't had discussions on that, as to whether or not they will in the long term do that, I mean obviously we're hopeful that whether it's the government returning or whether it's the opposition parties becoming government that they choose the accounting option that we've laid out here because –well accounting option –the accounting answer here that we've laid out because it is the right one. So we're hopeful that, you know, a choice will be made to adopt it.

Q. Walsh: Ms. Lysyk, I'm wondering if you can speak to how the government is characterizing this. They sort of dismiss it as a dispute between accountants, essentially suggesting that it really doesn't mean very much.

And I wouldn't characterize it that way. I would say what we have here, and I'll talk specifically to the Fair Hydro Plan, is a situation where a piece of legislation – which is lawful, you know -- was created that establishes something as an asset in law, but that doesn't make it an asset for accounting purposes and this term of rate regulated accounting has always been discussed. What we have here is the government creating an accounting that it's using in its books. There's no independent rate regulator that has been involved in this. The Ontario Energy Board did not have a hearing where people could come forward and say their piece and then make a ruling. It's a government chosen decision, so all policy decisions of government should be reflected in their financial statements.

Q. Blackwell: I mean the government says it has experts on both these issues support its view of things, I mean could this just simply be a dispute amongst accounting experts? Or is it more clear-cut than that?

I think it's more clear-cut than that. I mean, there is you know when you look at –I mean, I know the names are already out there so I'm not speaking out of school, but in terms of KPMG, Deloitte, E&Y, none of those firms have given an opinion on the accounting on the government's consolidated financial statements. None of them have given assurance that this whole thing, all the different pieces, work together so that it leads to a clean opinion on the government statements. The Auditor General's in Canada are the only ones that audit government financial statements and none of those firms have had that conversation with me, in fact I've reached out and I said are you giving an opinion on this, do you have an opinion out there on this. And none of them have said yes.

Q. Walsh: Can you explain that a bit more what the significance of that distinction is, that you're saying you have the big picture, the whole picture, and they have a very narrow scope on just the Fair Hydro Plan, is that it?

So, for instance let's go to, so we have one –well first of all Deloitte really isn't in the mix, in the sense that Deloitte did some work for KPMG –So KPMG and E&Y are the only ones that had the contracts that I'm aware of within the public sector. So in terms of the pieces, each of KPMG and E&Y looked at their piece of the puzzle, but not at how it works at the top level and I've directly and very specifically said are you providing an opinion to the government on the consolidated picture and they say no.

Q. Rath: Is the government purposefully misleading the public?

You know, I can't say what motive or what communications have been made on this. I can just say that from our perspective this is legislated accounting and not public sector accounting, you know, in its natural way.

Q. Mulligan: So was it fudging the books, are they fudging the numbers to make it a far rosier financial picture than what it is?

You know, I'm not going to characterize it as anything other than saying that, you know, with respect to the Fair Hydro Plan we know that the intent was to try and design an accounting and financing structure that would, you know, keep the bottom line from being impacted by a policy decision and keep net debt from going up and that's what, you know, the people in the public service long with their advisers tried to do, but they didn't involve us, they didn't ask us about it. And at the end of the day they did not look at it at the holistic level of the government's financial statements. So, I would have to say that after many meetings and trying to, you know, discuss our position we reached a roadblock where there wasn't any point in us talking about this. So I would say that the concern here is that after the sort of predominant – preponderance of evidence that we presented to various parties on our position that it didn't seem to make a difference.

Q. Mulligan: So the bottom line, though, is their way of accounting makes the books look far healthier, your way of accounting makes it look like we have a much bigger deficit in the future and things aren't so rosy.

That's correct. That's correct.

Q. Artuso: The legislation was brought in so that voters would have a clear view of the state of the finances prior to voting, so what should voters assume? Some of this spending, the deficit, is promised spending it's not out the door yet, it depends on whether the government is re-elected. Are we looking at –so is the starting base for any political party looking at a five billion dollar deficit? I mean what are you looking at without the additional spending?

Yeah so, we're saying that the bottom line for 18-19 the deficit is higher by five billion dollars, that for 19-20 it's higher by five point six billion and for 20-21 higher by six billion dollars. So in the Pre-Election Report the deficits that are presented here are understated.

Q. Artuso: So any party say drafting a platform is starting with the five billion dollar deficit?

In our opinion, yes.

Q. Blackwell: How about for this year, 17-18, what would you – because the government said there's a surplus of 700 million, what would you --?

So we haven't, I mean that's - that's what we're on to next, we'll be auditing the Public Accounts for 17-18 so we'll be issuing that opinion in August. But, obviously the impact of not correcting these transactions will play out on the government statements, or if they booked it that would affect the number that's being publicly communicated.

Q. Walsh: And for taxpayers, why does this matter? Why are you saying that the five extra billion dollar deficit matters? Why are you pointing it out?

Because that is a true reflection of the financial position of the government, so you know to get a true, transparent picture of the finances it's important that that be recorded. It's also important that legislated accounting not be accepted in any province in Canada because if that were the case then any time there was a need to achieve a bottom line government would pass a piece of legislation allowing it to do it. As well, I think you know, for MPP's and people making decisions using government statements, you want those statements to include all expenses and that's all we're saying is, we're saying all the expenses need to be in the statements when there a result – when they result from a government policy decision.

Q. Walsh: And when you say legislated accounting that actually sounds like cooking the books –

You know, I think it's, in Ontario I think in 2012, the government passed legislation allowing it to create accounting rules and so is it lawful, it's lawful, but we audit against Canadian public sector accounting standards and so we're saying that in this case, in the case of the Fair Hydro Plan at the consolidated level and in case of the pension issue at the consolidated level, that they're not in accordance with accounting standards. But, you know, again, I – when I say accounting standards, I know how it's played out. It's like a dispute between accountants. I think it's more. I think the hydro issue is more fundamental to ensuring that when governments make decisions and, you know, they're held accountable for those decisions, and they should be on their statements.

Q. Smith Cross: (inaudible) so sure that when the IESO adopted rate-regulated accounting, it was doing that in preparation for the Fair Hydro Plan in order to keep this debt off the government's books?

That is correct. So we issued a special report on that. We've also talked about it in Chapter 2 last year. And what transpired there is that a five-year-old transaction was adjusted to put that asset on IESO's statements and put the market accounts on their statements. And that came about as a result of people planning to – planning the design of this structure. So it set in place a model that would then be used to design the legislation and then, you know, enable from a perception perspective the IESO to book a regulatory asset – or to call their asset a regulatory asset.`

Q. Mulligan: The finance minister is saying, 'look, we had all these accounting firms including KPMG signing off on this, so we're right.' What do you say to that? That they have hired all these accounting firms who are backing them up.

I would say that the government knew that we would have an issue with this accounting. And there was – there was an obvious understanding that we would take issue with it and there was intent to keep us out of the picture and the discussions. I would say that they had advisers, but advisers are different than somebody actually having to sign their opinion on something. So they paid their advisers well, and they got advisers, and the advisers gave them advice on pieces. You know, some of them gave them ideas of what to put in the legislation. So you know, 'what do we need to put in legislation so you'll sign a clean opinion on those statements?' So it was crafted in the legislation. It would be, you know, 'how do we deal with these market accounts, or should we call this a legislative asset?' So there was a lot of that happening, and I guess I would say that it's fine if governments get advice. You know, it's fine. We don't have a problem. But for us to have been intentionally left out of the loop in the hopes that, you know, the risk of us not taking issue this was balanced against doing something. And they took a risk, and unfortunately I would say for all the legislators and for the citizens, my stuff is pretty strong and we figured out what was going on and it's not right.

Q. Mulligan: So they blocked you? (Inaudible) allowed to do that to you in this position.

Well this is the thing, right? We are the legislated auditors. So, you know, you need to have transparent communication between anyone that's involved in preparing the books for the province of Ontario. And the fact that that wasn't, it didn't operate that way, is inappropriate. And as the auditor you need to know that when people are telling you things and giving you information, it's truthful. Because how else do you, you know – part of – part of that is a dependency on representations that are verbal to you. So I would say that, you know, going forward, I would really hope that if any future initiatives are designed, that before, you know, it's too, you know, too far ahead and there's too much vested in a decision, that they do seek our advice because my staff are the experts in public-sector accounting in government in Ontario.

Q. Walsh: (inaudible) or are you referring to the government in that answer?

Sorry?

Q. Walsh: In your answer, (inaudible), were you just referring to the IESO or to the government?

No, generally the government.

Q. Rath: In simplistic terms, you're saying that the government passed a law so they can create their own accounting rules so that they would look better fiscally and therefore mislead the public.

I would say that they put in place legislation that created a legislative asset, you know, to call something a regulated asset, in order to have the design produce the bottom line that they wanted. No impact on the bottom line of the province and no impact on net debt. So yes, it impacts the information that's being presented.

Q. Crawley: Auditor, if – given that you're communicating to the public – I know your main job is to communicate to the Legislature and you're communicating about very detailed accounting stuff here. What's the simplest way you can communicate what's gone on here to the public and using terms that regular people can understand?

Well, in terms of the pre-election report, the expenses in the pre-election report for the three years that are presented in there, have been understated. And so the deficits that are planned are actually – would actually be higher. So by five billion in 18-19; by $5.6 billion in 19-20; and in 20-21, six billion. And part of that comes from the Fair Hydro Plan and the Fair Hydro Plan accounting is legislated accounting. Now everyone throws around 'regulated accounting;' it's legislated accounting.

Q. Smith Cross: Auditor, on a slightly different subject, can you tell us how the government's forecasts on home resales and home-resale prices are different from the private-sector forecasts?

Yeah, they had – there's not as many sort of people you can go to – to get sort of (inaudible) checks on those, but the government has their own model, and my staff and team looked at that model and looked at more current information they had and we thought it was reasonable what they were projecting.

Q. Smith Cross: Can you tell us if there are higher prices, more resales? (Inaudible) housing market hotter or cooler than private-sector forecasts?

That's a good question. Bill, do you want to tackle that one? Because I – the specifics? Could you repeat the question?

Q. Smith Cross: Is – according to the government's forecasts, is the housing market hotter or cooler than the private-sector forecasts that are (inaudible)?

Unidentified: (inaudible) slowing down (inaudible).

Lysyk: slowing down.

Q. Walsh: So the government's off if the government has a more rosy view, is that what you're saying?

Unidentified: So the government has a higher home resale price rather than the private forecasters. Private forecasters are expecting the prices to go down (inaudible).

Q. Walsh: How much more? What's the difference?

Unidentified: Well so in one case it would be like 20 per cent lower, 20 per cent lower year-over-year compared to what the government's projecting.

Lysyk: But I think – I think that's – I think at the end of the day that, like, we rationalize based on looking at more current information they had so that's why we're, you know, we've said it's a slight risk and there was a little bit of a difference there, but it wasn't enough to say it's a serious – a serious issue.

Q. Jeffords: Auditor, I'm – I don't want to read too much into some of the comments you made about your staff and sort of catching these – these interpretations or accounting issues. It sounds as though you acted to push back against this government and maybe future governments flouting the rules (inaudible) and effectively make up their own standards. Did you feel like it was going to eat away at the credibility of your office and other watchdogs of the Legislature?

No. I mean, our mandate is to audit the public accounts, our mandate is to report on our findings to all members of the Legislative Assembly and through them, the citizens in Ontario. So, we're doing our job. You know, the fact that we're dealing with these issues - is they came up as part of us doing our work. It's not like we went looking for them. We respond, right? Things are done, and then we review, and we have to respond to them. So, I would say, we are doing our job.

Q. Reeves: I know your office is just looking at the numbers, but there is a political component to how those numbers are used once you release your report. When you and your staffer are working on this – is there any thought given to what the political ramifications might be about your report? Or your findings?

You know, we can't really think that way, right? I mean, we have to do our job based on looking at the numbers, looking at evidence. You know, looking to see whether the accounting is correct and put out a report that's fact based. Right? So, we're not, you know – we're not, we're not thinking about that. We can't. We're independent. You know, people that work in the office are not members of political parties. Our motivation is not for money. We're not paid advisors. You know, we're here to serve the legislature.

Q. McGrath: On the pension surplus, the government has always said that it used to count the pension surplus as its own revenue asset or (inaudible) it was, and that your office changed its opinion on whether that was proper accounting. Could you explain that?

Yeah.

Q. McGrath: What was the nature of the change?

So, when the budget that year was put out, the team noticed that revenues were being booked from the pension plans. Now we're going – how can you book revenues from the pension plans and that started a further discussion with the people in finance, in the ministry and I think at the sort of grassroots level, I think there was acknowledgement that we had a problem here. You know, it's like during an audit, things happen. Things pop up. Information becomes known to you. New information becomes known and so that's what happened. And we started to look at it closer and then we realized the trajectory on this too. There is no – this amount, if accounted for the way the government was proposing – it's continuing to escalate. And so the gap between, so you know if it's two million that's used to balance the budget this year, it'll be 3 million, 4 million, 5 million, 6 million - there's no end to it. You know, the only way it gets reduced is if there's actually a withdrawal of surplus or the minimum. Not all contributions, but minimum contributions to the pension plan are reduced. But as you can see, we said, the minimum pension plan contributions are not being reduced. They continue to pay about two billion dollars a year. And we don't have any evidence to allow us to say there is value to recording what we would call an asset on the government's statements. So accountants write it off, right? Until you show us proof that there's value to an asset - there's no value to it. So we're just - we're waiting. I mean, if the government tomorrow were to get us a letter signed by the Unions saying that they can reduce minimum contributions by X amount or they can withdraw funds from the pension plan, then we'll agree there's an asset, but until they show us, then there's no asset.

Q. McGrath: In just was it is the growing, was it the size of the...

It was – it was the magnitude. It was the trajectory but it was the hit that we saw revenue coming into pension instead it being an expense, that was, that was, that was the, what what's happening here now.

Q. Walsh: So while the government thinks it can do this?

It's also the fact that there is like a different discount rate used between the government's calculation of the pension plan liability and the pension plan itself. So it's sort of a theoretical, notional calculation which also kind of says to us, well there's no value because it's based on this theoretical calculation. So what's the substantial value to that asset? And that contributed to it as well. So it's both. It's both -- how well the teachers was doing and, and the different calculations used between the government and the teachers.

Q. Walsh: What is your experience with how the government has responded to your recommendations in context to your other provincial colleagues across the country? What would you generally expect the response to be, or the action to be?

Yeah, so you know, even based on my experience in the past in two other provinces, typically when there is an accounting issue you sit down and you discuss it, right? And you discuss the, well, first of all when there's something big, I'm going to go to the Fair Hydro Plan -- when there's something big that is happening and you're going to change the accounting in the public sector, typically that would be discussed. You know, is this allowable? Is this acceptable? What will you think of it as the Auditor General's office?

And that didn't happen here and that does happen in other jurisdictions -- not consistently, there have been episodes in other provinces where there have been issues raised but they eventually get dealt with. That one, that one, is, is big. The other, the other side of it is, typically in other jurisdictions, too, when you have a kid who was saying you have accounting issues you talk them through. But, you know, I think the response to us was rather than working with us it was getting a pension panel together and trying to say this pension panel was an expert panel and kind of say, well it didn't matter. This expert panel knows more than the Auditor General's office. So that is a reaction you typically don't see in other jurisdictions. And you know what? You, we're kind of, you know, you get used to the job we do and you, you, (inaudible) that and you know at the end of the day the work you're doing is correct. You're not getting paid to do that work, you know, in the same way that outside advisers are. And obviously if there's defensive tactics used there must be some sense of worry around – around the issue, right? OK thanks very much. Thank you.

N.B.: Comments captured are not verbatim quotes

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