

INDEPENDENT AUDITOR'S REPORT

To the Legislative Assembly of the Province of Ontario

I have audited the accompanying consolidated financial statements of the Province of Ontario, which comprise the consolidated statement of financial position as at March 31, 2017, and the consolidated statements of operations, change in net debt, change in accumulated deficit and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

The Government of Ontario (Government) is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as the Government determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Government, as well as evaluating the overall presentation of the consolidated financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for Qualified Opinion

Net Pension Assets Overstated, Annual Deficit Understated, Net Debt Understated and Accumulated Deficit Understated

As described in Note 16a to these consolidated financial statements, net pension assets are included on the Statement of Financial Position relating to the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan. However, the Government does not have the unilateral legal right to use this asset because its ability to reduce future minimum contributions or withdraw any pension plan surplus is subject to agreement with the respective pension plans' joint sponsors. Canadian public sector accounting standards require the Government to record a valuation allowance against this asset.

The Government did not record a valuation allowance for these pension plans at March 31, 2017. The Government also retroactively restated the March 31, 2016 comparative figures to exclude the valuation allowance previously included in the prior year's consolidated financial statements. This departure from Canadian public sector accounting standards has led me to express a qualified opinion on the consolidated financial statements for the year ended March 31, 2017 and on the March 31, 2016 comparative figures.

The recommendations of the Government's appointed Pension Asset Advisory Panel are not an authoritative source on the application of Canadian public sector accounting standards as implied in Note 16a to these consolidated financial statements.

Effect on Consolidated Statement of Operations

If the Government had correctly recorded the valuation allowance against the pension asset for the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan, the effect on the consolidated statement of operations for the years ended March 31, 2017 and 2016 would have been as follows:

	2017 (\$ million)	2016 (\$ million)
Annual deficit as presented	(991)	(3,515)
Effect of valuation allowance on:		
• Education expense	(1,364)	(1,480)
• General Government and Other expense	(80)	(351)
Annual deficit in accordance with Canadian public sector accounting standards	(2,435)	(5,346)

Effect on Consolidated Statement of Financial Position

If the Government had correctly recorded the valuation allowance against the pension assets for the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan, the effect on the consolidated statement of financial position as at March 31, 2017 and 2016 would have been as follows:

	2017 (\$ million)	2016 (\$ million)
Net pension asset as presented	11,033	9,312
Effect of valuation allowance	(12,429)	(10,985)
Net pension liability in accordance with Canadian public sector accounting standards	(1,396)	(1,673)

	2017 (\$ million)	2016 (\$ million)
Net debt as presented	(301,648)	(295,372)
Effect of valuation allowance	(12,429)	(10,985)
Net debt in accordance with Canadian public sector accounting standards	(314,077)	(306,357)

	2017 (\$ million)	2016 (\$ million)
Accumulated deficit as presented	(193,510)	(192,029)
Effect of valuation allowance	(12,429)	(10,985)
Accumulated deficit in accordance with Canadian public sector accounting standards	(205,939)	(203,014)

Inappropriate Consolidation of Independent Electricity System Operator (IESO) Market Accounts

As described in Note 16c to these consolidated financial statements, the IESO changed its accounting policy and applied it retroactively to recognize market account assets and liabilities. The market accounts track mainly buy and sell transactions between market participants (electricity power generators and power distributors). These market accounts, as recorded on the Province of Ontario's consolidated financial statements are not assets and liabilities of the Province of Ontario. The Government has no access or discretion to use the market account assets for their own benefit, nor does the Government have an obligation to settle the market account liabilities in the event of default by market participants. As a result, Other Assets and Other Liabilities are both overstated by \$1.652 billion (2016 – \$1.443 billion). There is no effect on the Consolidated Statement of Operations.

Qualified Opinion

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraphs, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Province of Ontario as at March 31, 2017, and the consolidated results of its operations, change in its net debt, change in its accumulated deficit and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Other Matters

Independent Electricity System Operator's (IESO) Use of Rate-regulated Accounting May Cause a Material Misstatement on the Consolidated Financial Statements of the Province of Ontario

I draw attention to Note 16c to these consolidated financial statements, which describes the IESO's retroactive adoption of rate-regulated accounting during the year. The recognition of rate regulated assets is not permitted when applying Canadian public sector accounting standards. This departure does not have a material impact on the Province of Ontario's consolidated financial statements for the year ended March 31, 2017 and my opinion is not modified in respect of this matter. However, the consolidated financial statements may become materially misstated in future periods, as a result of the legislated accounting prescribed under the *Ontario Fair Hydro Plan Act, 2017* (Fair Hydro Plan) and its related regulations as it is not in accordance with Canadian public sector accounting standards.

Financial Statement Discussion and Analysis

I draw attention to the Province of Ontario's Financial Statement Discussion and Analysis that discusses the Province of Ontario's financial results without properly reflecting the valuation allowance required in respect of the net pension assets and the recognition of the market accounts, as discussed in the Basis for Qualified Opinion Paragraph above.

Toronto, Ontario
August 18, 2017

Bonnie Lysyk, MBA, CPA, CA, LPA
Auditor General