TV Transcripts: The Agenda - May 7, 2018

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The Agenda: U Of T's Wally Smieliauskas On Provincial Budget Accounting Differences
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Steve Paikin, Host: A discrepancy between the numbers that the Ontario Liberal government presented to the public and what the auditor general says those totals should be amounts to a difference of about $20 billion over the next three years. How could two views produce such dramatically different figures? Well let's find out from: Wally Smieliauskas, he's a professor of accounting at the University of Toronto's Rotman School of Management and has by far the toughest name I've ever had to say on this program. But Wally, it's nice to have you here anyway.

Wally Smieliauskas, University of Toronto's Rotman School of Management: Nice to be here.

Steve: Let's just set this up with some numbers we're going to share. You know these numbers already. Sheldon, if you would, bring this graphic up. There is a discrepancy, as we pointed out. The Government of Ontario said it delivered a small surplus at the end of fiscal year, the budget they just announced, a little over $600 million, but they are also forecasting multi-billion dollar deficits over the years, in fact over the next seven years. However, the auditor general says that the government's numbers are not a reasonable presentation of Ontario's finances and that there was in fact an $11.7 billion deficit at the end of this fiscal year, that is what she projects, and that there will be $12 billion deficits in the three years after that. Let us try to understand this fight over numbers, shall we? Why are the government's numbers and the auditor general's numbers so vastly different?

Wally Smieliauskas: It's a difference of opinion. First, it's important to understand the auditor's task. It's to verify the numbers.

Steve: Which she has not done.

Wally Smieliauskas: Which she has not done. And so therein we get the disagreement and now we're getting a lot of press coverage and discussion about it, why is there a difference? It gets back to the assumptions that are being made, and some of the government accounting.

Steve: Okay but there's a difference of opinion and a difference of opinion.

Wally Smieliauskas: Yes.

Steve: This is a $20 billion difference of opinion.

Wally Smieliauskas: Yes.

Steve: I mean surely it's got to be more than that.

Wally Smieliauskas: Well you have to remember that a lot of this – and they make it clear in the reports, if you actually read the reports, they make lots of estimates. Both make clear they're making lots of assumptions, and the numbers might not be true. In fact, the auditor general concludes at the end of her most recent report, these numbers might not be realized.

Steve: Okay. Let's see if –

Wally Smieliauskas: So she’s qualified it.

Steve: She is qualifying it. Let's see if we can break down why the difference of opinion in this case okay? The government has got its version. The auditor general says your version is wrong and is not reasonable. The two areas of massive disagreement, I gather, are over pensions and electricity prices, or electricity bookkeeping.

Wally Smieliauskas: Yes.

Steve: So let's go through that. What accounts for the difference by a factor of billions of dollars as it relates to the bookkeeping around getting electricity prices lower?

Wally Smieliauskas: Well, the government is using a novel form of – well, setting things up differently. They've created what's called a special purpose entity. You've probably heard that term. It's being used by a lot of companies. The company that began using it was Enron.

Steve: That's not good, Wally. We know what happened to Enron. That was a shell game.

Wally Smieliauskas: When it's used legitimately, it can better reflect what's going on, if a company wants to finance certain kinds of activities and then they want that entity to make special arrangements based on their particular business model, the overall parent company can save a lot of money, so they can create this special purpose entity to do that.

Steve: Let’s see if I get this right. The Government of Ontario wanted to lower our electricity prices because they were getting a tremendous amount of public heat for this. So they went and they borrowed I think, what was it, $19 billion or something like that to help subsidize the lower cost of electricity. But that money, those loans, are not on the books of the Government of Ontario. They're on the books of Ontario Power Generation and we’ll have to pay back $40 billion decades down the road. So it's going to cost a lot to borrow that money. But the point is it's not on the Government of Ontario's books. The auditor general thinks that's no good. Who's right?

Wally Smieliauskas: I would side with the auditor on this one because they are creating a special structure for no real reason.

Steve: Well, the reason –

Wally Smieliauskas: To create a different accounting note.

Steve: The reason is to be able to say you've got a balanced budget.

Wally Smieliauskas: Well, but that's not a good enough reason.

Steve: It is an election year.

Wally Smieliauskas: The purpose of structuring things isn't to get a different accounting. If that's the only purpose, then there's no real underlying substance of support.

Steve: On this one you're siding with the auditor general?

Wally Smieliauskas: Yes.

Steve: Let's look at the other issue. The other issue was not just the subsidizing of electricity prices, the other issue is how to treat teachers' pensions, which is one of the biggest pools of money in the world right now, right? The size of the teacher pension plan. What's the nature of the disagreement between the two of them on that one?

Wally Smieliauskas: There happens to be a surplus in one of the plans, and the government – a net surplus, okay? There's a trustee of the plan somewhere holding all the assets and liabilities and making the disbursements and collections. The net position of that trustee is what's normally reported by any entity, whether it's a business entity or a government entity. So the government is proposing to do it that way. That's the normal way of doing it.

Steve: But the government wants to be able to say, that money which they don't really have access to, do they?

Wally Smieliauskas: No, they don't. They can’t use it.

Steve: But they want to be able to sort of claim they do so they can put it on their books as positive.

Wally Smieliauskas: Well, I guess you can think of it as saying, well, there's a surplus. We'll have to contribute less in the future.

Steve: And, again, if I asked you on pain of death, okay, whose version of the truth do you believe here, which would you say on this one?

Wally Smieliauskas: Well, this is all based on actuary, so that's the truth. There is a surplus. Now the government doesn't have access to it because over time – you know, the reason they have a surplus is maybe markets performed better than they expected or the government contributed more money, and whatever the reasons are, there's a surplus now but it might not continue, it might get reversed depending on markets and depending on, you know, government ability to finance the pension plan. So it's going to go up and down. Now it happens to be up. So everybody knows that that's the case with these pension plans, so I don't know why it's a big issue. It just happens to be an election year.

Steve: Well, that's the point, right? I mean, an election year – that's why these things matter because the government wants to be able to say look what great stewards of the books we are and the auditor general is saying, well, not if you fudge it like that.

Wally Smieliauskas: Well the auditor general should ask, what happened in the past? Did anybody raise it in the past when there was a surplus and the government put it in their accounts for that year? I would hardly think this is the first time this has happened.

Steve: Auditors are also asked to do other things besides sign off on the state of the books. One of the other things that they are asked to do is go into various ministries and do what's called value for money audits.

Wally Smieliauskas: Yes.

Steve: What are those?

Wally Smieliauskas: They're evaluations of the performance of the various government activities or government organizations, and the auditor decides how to measure that performance. So let's look at some examples. One that was in the news many years ago was evaluating the performance of nursing home care in this province. And the auditor decided to compare government-run nursing homes with private-run nursing homes. And they picked a simple statistic. They're not experts in health care or anything, so they tried to pick something that – so they picked mortality rates and it turned out to be much higher in the government-run ones. Now, they didn't give any – this is where it gets back to the philosophy of the auditor. Is the auditor a watchdog that barks whenever they see something might be a problem? If that's the purpose, well, then the auditor is serving the role. If you want the auditor to just only find fraud or be like a bloodhound, look for things like Sherlock Holmes, I guess, that's a different matter, and –

Steve: So the auditor is a dog either way, it's just depends what kind of dog you want the auditor to be.

Wally Smieliauskas: Yeah, what kind of dog.

Steve: I got it.

Wally Smieliauskas: Most auditors view themselves as watchdogs.

Steve: I got it. Now it seems to me or it sounds like, when you ask for a value for money audit, you're asking the auditor to do more than just make a financial decision here. You're asking for kind of a, in some respects, she won't like my using this word, but a political evaluation of how well or not things are going. Is that fair to say?

Wally Smieliauskas: I don't think so because all that's happening is they report the facts. So like when they reported the nursing home death rates, nobody claimed that was wrong. The auditor just is acting like a watchdog and then the owner is supposed to figure out, is there a real problem or not? In other words, the government, the legislature, should do the follow-up and decide if this represents a problem or not. And that's the philosophy I think the auditor general tends to follow all over.

Steve: Who invented this whole value for money audit idea in the first place?

Wally Smieliauskas: From my understanding, it was an auditor general in Ontario from back in 1970 and they convinced the auditor generals around Canada to amend the act. So there's an auditor general's act at the federal level from 1977 and that's the one I think that created at the federal level and then many provinces follow that.

Steve: So this whole idea started in Ontario, Canada?

Wally Smieliauskas: In Ontario, yes.

Steve: Is it done anywhere else in the world?

Wally Smieliauskas: Well, it's spreading. That's the interesting thing. This is an example of a type of auditing that other auditors notice. They notice the media impact and auditors don't like to be ignored. Before that auditors were ignored for many years because their reports were boring. Or they would report – typical government accounting back then is you would have a certain amount that's been budgeted and all the auditor would report is whether the amount spent exceeded the amount budgeted or not. Not very exciting, right? So that's why they developed this value for money auditing. But since that time also the financial reporting has evolved and as you can see with the controversies now the auditors are getting much more involved. Essentially the government is adopting accounting principles from the private sector. That's what's been happening over time.

Steve: Well Wally, thank you very much for that. I think we get this all a lot better now than we did before we got you in that chair. So thanks so much for coming in tonight.

Wally Smieliauskas: Thank you.

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The Agenda: Accounting Dispute With The Auditor General
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Steve Paikin, Host: The dispute between the provincial government and the Auditor General over what the real budget deficit is may be fascinating for accounting nerds, but does it mean anything for the economics and politics of the province going forward? Here to help with that: Sheila Block, Senior Economist at the Canadian Centre for Policy Alternatives; Walid Hejazi, Associate Professor of Economic Analysis and Policy, and Academic Director, at the U of T's Rotman School of Management; and Martin Regg Cohn, Ontario Politics Columnist, Toronto Star. It's good to have all three of you back at TVO to help us out with this. Let us get your positions on the record before we start here. You know that the province of Ontario claims that the books are balanced, in fact a little small surplus for the fiscal year we are just exiting. The Auditor General says no. In fact, we have a $20 billion accounting dispute because she thinks the books are in much worse condition and has not, quote, unquote, signed off on the Ministry of Finance's math. Let's go through this. Who's right?

Sheila Block, Canadian Centre for Policy Alternatives: Well, they both are.

Steve: I was afraid you were going to say that.

Sheila Block: Sorry, I really think in terms of the valuation of the pension assets, you know, out of the blue the Auditor General said there's a problem here. The province really established a blue ribbon panel and they said, no, there's nothing offside here. And something that really maybe shouldn't have started, really shouldn't be continuing. So that's the pension part of it. The other part of it is how the debt associated with the Fair Hydro Plan is being treated, and on that we had a change in accounting policy that happened to coincide with the political and policy desires of the current government, and expert opinion on that one seems to be at best on the fence. So a little bit of both in my view.

Steve: Walid, how about you?

Walid Hejazi, Rotman School of Management: I think when it comes to the Fair Hydro Policy, I think it's completely misleading what the government has presented. And I think the change in the policy of the government in terms of how to report this was not a coincidence. I think it's done specifically for the purpose of making the books look better than they actually are, and the fact that several of these accounting firms have approved it means it's legal but it doesn't mean it's fair. And the last thing I have to say is the commentary by the CD Howe that was just released shows the transparency grades for the

Ontario government, and they've gone from A minus to B to C. Clearly the government has been implementing these kinds of creative accounting practices to make the books look better than they actually are, and I think, as an academic and as the informed public, that should be brought out for the public to understand that that's the motivation for it.

Steve: Okay. We have one vote for the Auditor General, we have one sort of a little bit on each side. Martin, we know where you are on this. Go ahead.

Martin Regg Cohn, Toronto Star: Well, it depends who you ask. If you ask the Auditor and which auditor you asked, if you ask the Auditor three years ago if the pension accounting was accurate, she not only would have said yes, she signed off on it. So it has been actually legal and accepted, generally accepted accounting principles – if there are such a thing – since 2002 under the Progressive Conservative government. About two or three years ago, she had a change of mind. She decided to change her previous accounting practices, just at the time as the Liberals – before the Liberals were about to balance their budget. Perhaps that was a coincidence, Walid, I don't know. The point is: it really is an accounting dispute and there have been accounting disputes ever since accountants came up with the idea of depreciation which is a pretty abstract concept if you think about it. On the pension one, they brought in a bunch of other experts, in fact, who were pension experts, accounting experts, the controller of New Brunswick who was not a Liberal hack for all I know, and they said she was dead wrong. On the Fair Hydro Plan, that's a really more complicated one and I think it is aggressive accounting but it's the same accounting they used at Toronto Hydro, that's been used in Alberta. Would I do it myself, no but I struggle with depreciation.

Steve: Hold on. Let me follow up on one thing you said. It is a fact as you have chronicled it that the Auditor General changed her mind. What previously she was okay to sign off on she now says is not acceptable and is not reasonable anymore. Her position on this has been – she was on this program, she told us – her position on this has been I haven't really changed my mind. I always thought this but since this was the way it had always been done in Ontario history, I wasn't prepared to go to the wall at that point. But now she says it's time. Do you accept the explanation?

Martin Regg Cohn: That's fair ball. I don't think we should – in Canada we have this peculiar Canadian love of debating two things: prorogation, for some reason and you're probably guilty of that; and this idea of treating Auditor Generals as gods, as rock stars, and it started with Kenneth Dye who I covered decades ago and Sheila Fraser and we think that they're like the pope, they're never wrong.

Steve: They're non-partisan, that's why they tend to get extra weight.

Martin Regg Cohn: Well except when they are I’m not for one moment suggesting that she is partisan. I’m not but Andre Marin turned out to be partisan. There’s another independent non-partisan officer of the legislature – an ombudsman, who then ran for the Progressive Conservatives. The Environmental Commissioner ran for the Green Party as soon as he quit. Let's not pretend that they're gods. I’m not suggesting she is dead wrong about everything. I think she does a lot of terrific work. Most of what she does is quite valuable but on the pension thing, I’m not an expert, but they brought in four experts who said she was dead wrong.

Steve: I have an expert sitting beside me here, so I want – can you take us through in as Economics 101 a way as possible, the nature of the disagreement on the pension issue. The government clearly thinks one way. The Auditor General obviously thinks a different way and the result is a multi-billion dollar disagreement. What's the nature of it?

Sheila Block: The nature of it is how do you treat assets in a pension plan, right? And I think the nature of it is, you have assets and you have liabilities. There is government responsibility in part for those assets and liabilities. And I think the issue is really one of consistency. That if she was willing to take on the liabilities with the government, then you also need to, in that kind of balancing, also account for the assets. But I think, you know, I think we want to step back a little bit from this and talk about where this Auditor General has kind of stepped out beyond her expertise. And I know on some economic issues, I’ve had some questions about her claims.

Steve: Like what?

Sheila Block: For example, when she decided that she wanted to calculate how long it would take to pay off government debt, and that was maybe two or three years ago. And that's – governments don't have to pay off debt because as we economists like to say governments are infinitely lived, right? So it's not a relevant concept. But again I think it was something that would grab a headline. And so I think similarly with this issue, she's crossing a line between actuarial expertise and accounting, and she slipped there. And I have to agree with Martin, she slipped there and didn't acknowledge it and I think, to a certain extent, we have an Auditor General here who is cried wolf, and when she raises something that's I think more legitimate, like the issue around the borrowing around the Fair Hydro Plan, she's got a little bit less credibility because we've heard this before from her.

Steve: Let me get Walid on that. The expression in politics is she is too far out over her skis. Do you think she is?

Walid Hejazi: I don't think. I want to stay on the exact issue we're talking about. And when you look at – even in valuing the pension assets, there's a footnote in the CD Howe Institute commentary that shows the discount rate the government is using for the liabilities is higher than what the pension plan is using. All of this to say in English is that the government is overstating the assets they have in the pension. But I think it's really important –

Steve: Sorry. To what end?

Walid Hejazi: To make it look like they have more assets available to them.

Steve: And therefore the books look better for them.

Walid Hejazi: Absolutely. So there's three big things going on. All three of them work in this government's favour. I think the big advantage for this government, however, is the fact that the criticisms from the NDP and the Conservatives is very disingenuous because they too, in their budgeting and their platforms are also using the same accounting approached. I think it's very important for the viewers to understand that the books that the government is presenting and that the other two parties have also blessed in their platform development, they're not giving an accurate representation. Just think for a minute that there's a structure they created and within that structure, this trust, they have an asset. What is the asset that this government has created is the right to get these additional subsidies from future rate payers. What kind of an asset is that?

Steve: This is the hydro argument now.

Walid Hejazi: Yes. It ties the hands of future governments and I think secondly and most offensive is the idea that by using this creative approach, the cost to finance this creative approach is $4 billion higher than had the government simply taken those liabilities and put it on their own books.

Steve: But as a political problem, it's gone away.

Walid Hejazi: As a political problem, it's gone away.

Steve: Well, that was the point, wasn't it?

Walid Hejazi: And they're successful at it and we know the hydro costs have come down. It's no longer a top concern of Ontarians.

Steve: Let me follow up with Martin on one thing you said which is it is a fact that the Progressive Conservatives and New Democrats have put forward to the extent they have, the NDP a lot, the PCs not so much, spending plans based on the same arithmetic, based on the same accounting principles that the Liberals are now being criticized for. And when the Tory Finance Critic was asked the other day: are you therefore, when you get into government, if you get into government, going to abide by the Auditor General's ruling, there was a – well, we're not answering that question yet. So really, is everybody kind of covered in mud on this one?

Martin Regg Cohn: Everybody. To use Walid's term, a footnote. The New Democrats are actually not endorsing the Fair Hydro Plan. They say they'll scrap it, to their credit, I guess. They also say they will reduce hydro costs by 30 per cent. They haven't said how they’re going to do that.

Steve: Well, by buying back Hydro One, is what they said.

Martin Regg Cohn: Which has something to do with raising or lowering costs, as you know, so that costs billions of dollars more to buy back the corporation –

Steve: You heard it.

Martin Regg Cohn: But the Progressive Conservatives are on record in their platform which they issued and then Doug Ford suspended as saying that they would endorse the Fair Hydro Plan and they accept the Auditor General's numbers. They don't accept it. They're using it. They're basing their platform on it. So everyone will have the same numbers.

Steve: They haven't said they'll do their budgeting if they're government to satisfy the Auditor General.

Martin Regg Cohn: No, but Doug Ford has said, the leader of the PCs, that he would call in an independent outside group of auditors to audit what's going on. So all that complaining that the Liberals brought in somehow a stacked panel of experts to deal with the Auditor, looks like the Tories are going to do their own outside panel.

Steve: Does that look to you a lack of faith in the Auditor General's ability to go through line by line the books?

Martin Regg Cohn: I don't know if that's a fair inference for me to draw but it certainly allows people to say well, why can't the Auditor? And that comes back to Sheila's point that I think there is a bit of a credibility problem that attaches to the Auditor General. Walid raised this footnote of what's the discount rate. By the way, the Auditor plays with the social discount rate as well. She did that with the gas plants to come up with her billion dollar boondoggle. Everyone likes a billion dollar boondoggle and so she played with all kinds of numbers to make it high. I'm not suggesting that wasn't a boondoggle.

Steve: But you won't know for 20 years how much it really cost.

Martin Regg Cohn: This is not a billion dollars that hasn't been spent. This is projected costs over time of transport costs and taxes and everything else. This idea of a footnote may be higher or lower is perhaps a valid point but it's beside the point. There is a surplus. Everyone agrees there is a pension surplus, whether it's $10 billion or $8.4 billion, it doesn't matter because if it's $11 billion the Auditor still says, poof, that surplus doesn't exist. If there were a liability, if the pension fund hadn't performed as well as it has, if the government hadn't paid all those premiums and the unions as well, she would say, oh my goodness, there's a $6 billion liability. Your debt is higher by $6 billion and your deficits. What she has said is that surplus doesn't count for anything because –

Steve: You can't touch it.

Martin Regg Cohn: Because he government can't raid the pension fund. Well, no one can raid pension funds in Ontario. It's a myth that you can do that, let alone a government. What a government can do say is we have all this money piling up. At some point we could reduce our contributions and that would reflect positively on the balance sheet.

Steve: You made quite the face. Can you tell us why?

Sheila Block: I think if we just take a further step back here and there are a couple of kind of big issues here, one of which is, if governments want to get more engaged in the economy or society by reducing hydro rates or by doing other things, they've got to pay for those things. And a lot of this creative accounting comes from that fear of raising taxes. So I think that's one element. And the other element of it is part of the way that you kind of shuffle aside from that is by privatization. And I think what Walid was saying was, those privatizations do wind up costing and they cost because you have higher borrowing costs if you're away from government, and there's also costs associated with it because very legitimately private entities need to make profits that governments don't. And when you have a natural monopoly like hydro, there's no benefits in any of our courses that we took from competition in that natural monopoly. And so I think over the longer run, there would be a decrease in hydro costs associated with bringing it back into the public sphere and there's research that kind of backs that up in terms of hydro providers in Ontario when you compare their costs and no difference in efficiency, sorry.

Steve: Do you agree with Martin Regg Cohn's point, though, that taking all of that borrowing off of the Government of Ontario's books, putting it on the books of Ontario Power Generation, borrowing whatever it was, $13 billion today, having to pay off $40 billion decades down the road in order to subsidize electricity costs for this generation, do you agree that that's overly aggressive in terms of accounting?

Sheila Block: That's pretty aggressive accounting.

Steve: Pretty aggressive. That's as far as you'll go.

Walid Hejazi: What's incredibly unfair about this is we're affecting future generations, this policy to have a political end, it's affecting future generations that never had a chance to vote on it. But I want to step back and more broadly –

Steve: You have a minute and a half to step back more broadly.

Walid Hejazi: In 30 seconds. I had a conversation with a Minister and I asked that Minister, if you had a year to come to Rotman and write, what would you write about? He looked at me and said, Walid, I would write about public trust in government. And I would argue that this kind of lack of transparency eats away at that kind of public trust. I just think if the government wants to reduce hydro bills, I'm not opposed to it. I just think they should be transparent and let the public understand that this affects the bottom line not by hiding it somewhere else.

Steve: I'm taking notes here. The name of that Minister was...

Walid Hejazi: I cannot say. I'll tell you off the record.

Steve: Okay, you can tell me after we're done. In our last 30 seconds, I know this has been a subject of discussion among a certain type of person, let's put it that way. Could this be an election issue?

Martin Regg Cohn: Oh, absolutely. This pre-election analysis by the Auditor ironically was something that was brought in by the Liberals in 2003 after they had been in opposition, in order to bring out transparency in reporting. So the opposition can and will use it despite their the fact that it might come back against them. But this idea that somehow this has been hidden, all of these numbers are completely transparent. That's the point. I think, with respect, Walid, the Liberals set it up years ago so that they would have to report it before an election. So this is all out there. All these numbers. That's why we're having this conversation. There is no hidden numbers here. That's why Bay Street has looked at it and the credibility rating agencies haven't disagreed with the actual numbers.

Steve: And the member for number one Yonge Street gets the last word today on this program. Walid Hejazi from the Rotman School. Sheila Block from the Canadian Centre for Policy Alternatives. Martin Regg Cohn from the Toronto Star. Great to have all of you on TVO tonight. Thank you.

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