TBS

Office of the Provincial Controller Division

Accounting Issues Update

Briefing to Secretary of Cabinet

March 21, 2017

CONFIDENTIAL DRAFT– FOR DISCUSSION ONLY

Topics for Discussion

- Status of Key Accounting Issues
  1. Pension Accounting
  2. H1/OPG Consolidation
  3. BPS Line by Line Presentation
  4. Electricity Rate Mitigation
  5. Cap and Trade Accounting
  6. Accounting for Transit Assets
  7. Accounting for Transfer Payments
  8. Contaminated Sites
  9. Accounting for other GBE Transactions
  10. EDU Remedy

Purpose

- To provide an update on key accounting issues with significant potential fiscal impact

Summary

	Issue	Fiscal impact in 2016-17	Reflected in Q3	Multi-year impact
1	Pension accounting – valuation allowances - Reversed FES treatment for OTPP/OPSEUPP - Panel recommended full valuation allowance for CAATPP and HOOPP	$14M CAATPP $0 HOOPP	Yes	Yes
2	IFRS-US GAAP differences – OPG and H1 - Decision to adopt IFRS announced in Q3 - OPG 'preferred' approach will be used	$0.1 B	Yes	Yes ($2.6B over 5 years)
3	BPS line-by-line consolidation	No	No	No-fiscal impact
4	Electricity Rate Mitigation	$100M	No	Yes
5	Cap & trade proceeds -- Revenue from 1st auction to be reported in 17/18	$478 Million	Yes	No
6	Metrolinx MOU with City of Toronto	TBD	No	Yes
7	Year-end transfer payments (e.g. Affordability Fund, AI)	TBD	No	No
8	Contaminated sites – i. OAG follow-up audit, ii. New liabilities in 2016-17	$54.1M – TBD	$47.5M	Yes
9	Other GBE issues (H1 sale; unrealized gains/losses)	$538M (H1) $180M (BH)	2016 Budget amt (H1 only)	No
10	EDU Remedy	NIL currently	NIL	Depends on timing of settlements

1. Pension Asset Accounting

OTPP and OPSEUPP

- Fiscal impact originally included in FES **for valuation allowances** was based on AG's position ($2.2 Billion in 2016-17, higher amounts in out-years)
- Panel recommendations on OTPP and OPSEUPP were adopted in Q3 update and the valuation allowances recorded in 2015-16 were reversed
- Technical briefing on Panel's recommendations held February 13, 2017
- AG briefing in response to Panel's report held February 16 confirms disagreement with conclusions
- FAO implied during discussion on March 17/17 that they would present impact of both views

HOOPP and CAATPP

- Panel has completed work on HOOPP and CAATPP and recommended valuation allowance be taken based on current governance structure; DM and MO briefing on March 20, 2017
- Full valuation allowance for 2016/17: HOOPP – NIL, CAATPP - $14M
- For PRRT, full valuation allowances for 2017-18; HOOPP - $102M, CAATPP - $25M; significantly increases in out years (2018-19 -- $765M, 2019-20 - $914M)
- Exploring potential changes in governance structure to align accounting for HOOPP and CAATPP with other joint sponsored pension plans

All Plans

- OPCD provided updated estimates of pension liability and expense in February
- External actuarial advisor engaged to complete valuation allowance documentation on all plans

2. Consolidation reporting basis for Hydro One and Ontario Power Generation

(US GAAP vs. IFRS)

- FES reflected US GAAP based results for OPG and H1
- Q3 Announced adoption of IFRS based reporting for OPG and H1 effective with the 2016/17 Public Accounts
- AG notified prior to Q3 release
- The net impact of adopting IFRS (IFRS14) for the Public Accounts will reflect OPG's preferred method of valuing its nuclear asset retirement obligation
- Status
  - Updated estimates of impacts to be received from OPG by end of March
  - OPCD working with OAG, OPG and H1 on supplementary audit requirements
  - OAG has confirmed that OPG's supplementary information requirements can focus only on the 'preferred method' of accounting under IFRS for asset retirement obligations (AROs) but continues to require that procedures be performed to statutory level of materiality that would be required if OPG"s f/s were being audited

3. Consolidation Presentation
(BPS Line by Line Reporting)

- AG preference for line by line consolidation of hospitals, school boards and colleges on statement of operations, as well as consolidation of Children's Aid Societies
- Status:
  - Hospitals, school boards and colleges to be implemented on line by line basis beginning with the 2016/17 Public Accounts, including 5-year historical trend analysis
  - Plans for change communicated to OAG
  - Discussions held with ministry stakeholders and formal notification of decision provided
  - Impact of potential consolidation for CAS initiated; for consideration for future years

4. Electricity Rate Mitigation

- Accounting for Global Adjustment (GA) deferral mechanism and the Affordability Fund are particularly complex
- MOE, MOF/OFA, TBS, OPG, H1, IESO and external advisors have collaborated on transaction structures and fiscal implications over the past several weeks.
- Affordability Fund:
  - OPCD engaged in reviewing draft trust documents and transfer payment agreement, expectation that initial transfer of funds will be made prior 2016-17 year end ($100M)
  - Hydro One engaged auditor to provide accounting opinion on consolidation with Hydro One
- GA deferral mechanism -- If all requirements can be met, an accounting analysis is expected to support: (1) increase in provincial borrowing (2) no increase in net debt, and (3) no impact on annual surplus/deficit, but depending on funding to OPG/Trust from Province, an increase in interest on debt and an increase in income from OPG (to offset IOD increase) will result.
  - Draft legislation and financing structure critical to informing accounting analysis
  - High audit risk re: intended accounting treatment, including:
    - AG acceptance of rate regulated accounting on IESO books being reflected on CFS
    - OPG's role in structure re: transparency
  - Complexity of structure and length of deferral/recovery increase risk
  - IESO to modify basis of reporting for March 31, 2017 financial statements and obtain external accounting opinion supporting rate regulated accounting
  - OPG to obtain external accounting opinion on accounting for OPG Trust
- Auditor General requested briefing – scheduled for April 12, 2017

5. Cap and Trade Accounting
(for 1st Auction Proceeds)

- Accounting analysis on recognition of proceeds from March 2017 auction shared with OAG
- Revenue from first auction (March 22, 2017) to be reported in 2017-18 under both Province's and AG's accounting approach
- Province's accounting policy -- revenue recorded in period when Province' transfers emission allowances to purchasers, including current and future vintages
- Status:
  - AG and OPCD disagree on revenue recognition point; however, difference would have no impact on the 2016/17 Public Accounts as it would be recognized in 2017/18 under either approach
  - AG believes revenue should be recognized on the date the auction in certified
  - Based on existing WCI timelines, future timing of auction is not expected to result in any difference, but monitoring will be required

6. Accounting for Transit Assets
(Metrolinx MOU with City of Toronto)

- FES reflects assets will be Provincially controlled (TCA, depreciation impacts vs. transfer payments)
- Accounting risk – if assets assessed as **not being controlled by the Province**, assets would be written off of Province's balance sheet and considered transfers to the City of Toronto
- Status:
  - OPCD engaged with Metrolinx and MTO in early 2017
  - Discussions expanded to also include PwC (Metrolinx's external auditor)
  - Metrolinx responsibility to identify potential accounting risks clarified
  - Metrolinx has engaged PwC to issue an accounting opinion based on binding Agreement in Principle between Province and City
    - No certainty that agreement will be signed by March 31, 2017

7. Accounting for Transfer Payments
(year-end transfers)

- Audit issues during 2015-16 Public Accounts reversed planned accounting for Green Investment Fund expenditures ($325M)
- Expenses originally planned to be reported in 2015-16 for GIF are to be reported in 2016-17 (reflected in FES)
- Status:
  - OPCD/OAG discussions occurred to confirm details of accounting treatment; documentation exchanged to confirm application of accounting standards
  - Updates on 2015-16 experience provided to financial community (FCC, FBMC)
  - Updated guidance posted on Sharepoint
  - OPCD engaged with a number of ministries on transfer agreements that are expected to be signed before March 31, 2017

8. Contaminated Sites

i. AG Follow-up audit on VFM audit for contaminated sites
   - OPCD, OIAD and ministries collaborated on updated status of responses to 2015 VFM recommendations
   - Initial information provided to AG on March 21, 2017
   - OIAD also engaged to undertake review of contaminated sites accruals in advance of OAG fieldwork; steps being taken to optimize OAG reliance on OIAD work

ii. New contaminated sites for 16/17
   - Additional liabilities of approx. $54.1M identified in 2016-17.
   - Grassy Narrows -- potential liability based on actions taken by government (constructive obligation). OPCD is working with the MOECC to confirm the accounting treatment
     - Internal legal opinion from MOECC – moderately low risk that court would find Ontario is legally required to expend funds based on statements made

9. Accounting for Other GBE Transactions (H1 Sale, Brampton Hydro Sale, etc.)

- Gain from second tranche of Hydro One sale to be recognized in 16/17, excluding gain on sale of shares to OPG (related party) which will be deferred.
- Accounting analysis for Brampton Hydro sale being drafted by OPCD (est. gain $180M) in 16/17 to be shared with the OAG by March 31, 2017
- Status:
  - OPCD analysis of various energy sector transactions shared with OAG as complete, including review by external advisors.
  - Control analysis on Hydro One HoldCo to be undertaken based on anticipated transactions

10. EDU Remedy

- Ministry of Education advised that:
  - Negotiations are on-going with the unions.
    - Negotiations for four unions are completed but represent a small number of members therefore estimation via extrapolation is not advised.
  - Remedy solutions have differed among the unions.
  - Any settlements up to the date the financial statements are issued (e.g. mid-August) will be taken into consideration to determine the adjustment, if any, required to reverse an over provision or accrue an under-provision.