Ontario

2016-17 Public Accounts

Technical Briefing

September 7, 2017

Purpose of today's briefing

1. Provide an overview of the results for fiscal 2016-17
2. Highlight the changes made in the 2016-17 financial statements:
   a) Accounting for net pension assets of jointly sponsored pension plans
   b) Accounting for the Independent Electricity System Operator (IESO)
   c) Accounting for hospitals, school boards and colleges
   d) Accounting for energy sector government business enterprises (GBEs)

Preparation of the Financial Statements

- The consolidated financial statements are prepared by the Government of Ontario in accordance with the accounting principles for governments recommended by the Public Sector Accounting Board (PSAB).
- PSAB independently establishes accounting standards for the public sector in Canada.
- The objective of PSAB standards is to meet the needs of users of financial statements by providing the information needed for accountability and decision making.
- PSAB standards specify how transactions and other events are to be recognized, measured, presented and disclosed in a public sector entity's financial statements.
- PSAB recognizes that their standards cannot address every potential situation, and that it may be necessary to refer to other sources of guidance.
  - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances. (Section PS 1150)*

Summary 2016-17 Results

2016-17 Actual Results

$ Billions	2016-17 Budget[1]	2016-17 Actual	2015-16 Actual[2]	Change from Budget	% Change
Revenues	138.5	**140.7**	136.1	2.2	1.6%
Expenses	141.8	**141.7**	139.7	(0.1)	-0.1%
Reserve	1.0	**-**	-	(1.0)	
Annual Deficit	(4.3)	**(1.0)**	(3.5)	3.3	-76.7%
Net Debt		**(301.6)**	(295.4)		
Accumulated Deficit		**(193.5)**	(192.0)		

[1] 2016-17 Budget has been reclassified to reflect the change in presentation for third party revenues of hospitals, colleges and school boards (no change to deficit)
[2] 2015-16 Actual has been restated to reverse the impact of regulated accounting for pensions

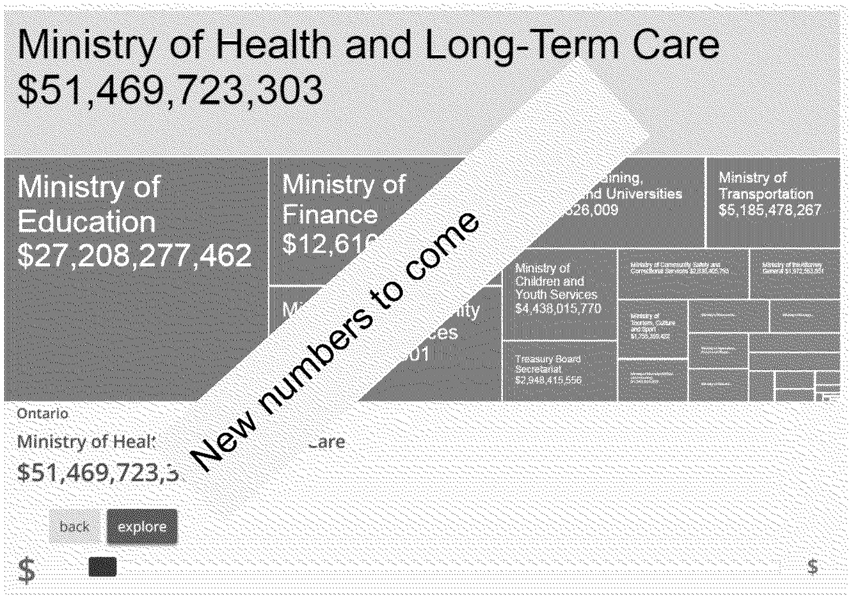
Ontario

2016-17 Highlights

- The 2016-17 Public Accounts of Ontario show that Ontario's deficit is $991 million. Ontario has beaten its deficit target eight years in a row.
- The deficit is $3.3 billion lower than projected in the 2016 Budget and $0.5 billion lower than the interim projection in the 2017 Ontario Budget. This is a result of growth in revenue that exceeded growth in program expense, and lower than forecast interest on debt.
- Ontario's real gross domestic product (GDP) was 2.7%, up from 2.2% in the 2016 Budget. Over the last three years, Ontario's GDP growth has outpaced that of all other G7 countries.
- Net debt-to-GDP continues to be forecasted lower than expected for 2016-17 at 37.8%, an improvement over the 2016 Budget of 39.6%.

2016-17 Highlights

- Other highlights include:
  - Total revenue of $140.7 billion, up $2.2 billion from the 2016 Budget
  - Total spending of $141.7 billion, down $0.1 billion from the 2016 Budget



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Ontario

Accounting for Net Pension Assets of Jointly Sponsored Pension Plans

- Ontario Public Service Employee's Union Pension Plan (OPSEUPP) and Ontario Teachers' Pension Plan (OTPP) are jointly sponsored pension plans (JSPPs) where the Government of Ontario is a co-sponsor.
- The plans are funded on a 50/50 basis, co-managed by the sponsors, and decisions regarding benefits and contributions require negotiation and agreement between them.
  - On June 12, 2017, the co-sponsors of OTPP (Ontario Teachers Federation and the Government) announced a 1.1% reduction in contributions effective January 1, 2018
- Under PSAB standards, an asset arises when the government's total contributions to a plan, including interest earned thereon, are greater than the pension expense recognized since the start of the plan.
- Since 2001-02, the Province's share of pension assets reflected on the audited consolidated financial statements of the Province has been based on a policy considered to be consistent with PSAB standards related to accounting for retirement benefits. The standards have not changed since their issuance in 2001.
- In 2016, the government passed a time-limited regulation to require the full write-off of the net assets of both of these plans for the 2015-16 Public Accounts.

Auditor General's Position – Pension Accounting

- A qualified opinion was issued by the Office of the Auditor General on the 2016-17 consolidated financial statements regarding the Province's accounting for the net pension assets of OTPP and OPSEUPP and notes:
  - a full valuation allowance should have been recorded in 2016-17 (and prior years) to reduce the net pension assets of OTPP and OPSEUPP to NIL,
  - the Government does not have the unilateral 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 plan's joint sponsors, and
  - Canadian Public Sector Accounting Standards require the Government to record a valuation allowance against this asset.

Province's Position – Pension Accounting

- Based on professional staff's interpretation of PSAB standards, the government believes that pension assets for OPSEUPP and OTPP should be reported in order to fairly present the Province's financial position.
- The Province has shared control over the pension plan and the existing agreements in place between the sponsors support the recognition of the pension asset.
- The professional staff does not believe that the Government has the right to withdraw any surplus from the plan, and has supported the value of the pension asset solely on the basis of being able to reduce contributions in the future.
- The Province has recorded the pension assets for OTPP and OPSEUPP in its 2016-17 consolidated financial statements and has restated the 2015-16 consolidated financial statements to recognize the pension assets.
- With respect to the Healthcare of Ontario Pension Plan (HOOPP) and Colleges of Applied Arts and Technology Pension Plan (CAATPP), based on the difference in governance structure between these plans and OTPP and OPSEUPP, the Province has recorded a valuation allowance for CAATPP in the year (amount is not material). The HOOPP plan is not in a net asset position for accounting purposes at March 31, 2017.

Province's Position – Pension Accounting

- The professional staff's interpretation of PSAB standards is supported by its own research and analysis as well as:
  - The report of the Pension Asset Expert Advisory Panel (https://www.ontario.ca/page/pension-asset-expert-advisory-panel-report) released on February 13, 2017 stating that the Government should record an asset for its share of the surplus reported in the accounting valuations for each plan and that no valuation allowance is required.
  - An opinion from Deloitte LLP dated October 2, 2016 on OTPP, a summary of which is included in Appendix A, supporting the ability to recognize a pension asset in the absence of having a unilateral right to reduce contributions to the plan.
  - Analysis completed by EY as to whether any valuation allowance is required to be recorded for OTPP or OPSEUPP as of March 31, 2017. EY confirmed no valuation allowance was required for either plan.

Accounting for Independent Electricity System Operator and Market Accounts

- Independent Electricity System Operator (IESO) is a not-for-profit, non-taxable corporation established pursuant to Part II of the *Electricity Act, 1998*.
- IESO prepares its financial statements in accordance with PSAB standards.
- IESO's financial statements are audited by KPMG LLP, which issued an unqualified opinion on the December 31, 2016 financial statements.
- IESO is a party to agreements with market participants for which are there are amounts due *to* the entities that provide electricity to the market (e.g. power generators) and due *from* those who consume electricity (e.g. local distribution companies on behalf of their consumers).

- In 2016, IESO changed the accounting for the market accounts, recognizing the amounts to be settled as assets and liabilities, equal in amount. In prior years, these amounts were not reflected in the financial statements of IESO.
- IESO made the change to be better reflect its' administration of $17 billion in amounts due to and from the market participants.
- This change has no impact to the province's annual deficit, net debt or accumulated deficit.

Accounting for Independent Electricity System Operator and Market Accounts

- This accounting is consistent with the presentation used previously by the Ontario Power Authority (which was merged with the IESO on January 1, 2015) in its financial statements, which was not subject to qualification from the Office of the Auditor General at that time.
- Additional background on IESO:
  - On January 1, 2015, IESO was amalgamated with Ontario Power Authority (OPA) and continued as IESO.
  - Prior to the amalgamation, OPA prepared its financial statements in accordance with PSAB standards.
  - OPA's last financial statements prior to amalgamation were audited by KPMG LLP, which issued an unqualified opinion on the December 31, 2014 financial statements.
  - OPA's audited financial statements included a segment of the market accounts.
- The Province consolidates the financial statements of the IESO (and the OPA until it amalgamated with the IESO)

Auditor General's Position – IESO Market Accounts

- A qualified opinion was issued by the Office of the Auditor General on the 2016-17 consolidated financial statements regarding the change in Independent Electricity System Operator's accounting for the "market accounts" noting:
  - the market accounts are not assets and liabilities of the Province, and
  - 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.

Province's Position – IESO Market Accounts

- Based on professional staff's interpretation of PSAB standards, the government believes that reporting the IESO's market accounts in the consolidated financial statements of Province is more transparent accounting.
- The IESO is a party to the contracts with each market participant, and each market participant either owes an amount to the IESO or is owed an amount from the IESO.
- For example:
  - Ontario Power Generation has a receivable from IESO recorded on its financial statements related to power generated, and historically, IESO did not have a payable recorded to Ontario Power Generation – now it does
  - Hydro One has a payable to IESO recorded on its financial statements related to power purchases, and historically, IESO did not have a receivable recorded from Hydro One – now it does
- The amounts due from market participants meet the definition of an asset and the amounts due to market participants meet the definition of a liability under PSAB standards.
- The IESO reviewed the accounting for eight other independent system operators in North America, and all but one recognize market accounts in the financial statements.
- IESO management, their Audit Committee, their Board of Directors, their external auditor and the Office of the Provincial Controller support the change in accounting.

Accounting for Hospitals, Colleges and School Boards

- 2016-17 Public Accounts present third-party revenues for hospitals, school boards and colleges with provincial revenue.
- In prior years, these revenues were netted against the expenses of the respective sectors (health, education, post-secondary).
- This is a change in presentation only.
- The changes increases total revenues and expenses by approximately $8 billion.
- There is no impact to the Province’s deficit, net debt or accumulated deficit.
- This change is consistent with PSAB standards and the reporting practices of other senior Canadian governments.
- This change was adopted in response to recommendations by the Auditor General.

Ontario

Accounting for Energy Sector Government Business Enterprises

- The 2016-17 Public Accounts include the financial results of Ontario Power Generation (OPG) and Hydro One using International Financial Reporting Standards (IFRS).
- These two government business enterprises currently report their stand-alone financial results using Generally Accepted Accounting Principles in the United States (US GAAP).
- In prior years, the reported results of OPG and Hydro One were included in the results of the Province based on US GAAP.
- This change does not have a material impact on this year's Public Accounts.
- The change to reporting under IFRS for OPG and Hydro One was recommended by the Auditor General.

Appendix A – Deloitte Summary of Accounting Opinion Issued on Pension Accounting

Deloitte was engaged to provide a report ("Deloitte Report") on the application of accounting standards by the Ontario Treasury Board Secretariat. Our report, which was issued on October 2, 2016, was prepared under professional standards for such reports set out by CPA Canada.

The subject of this report was the application of Public Sector Accounting Standards (PSAS), as established by CPA Canada, in the recognition of a pension asset in the Province of Ontario's financial statements. Pension accounting is subject to professional judgement and interpretation, and involves significant accounting estimates. The Deloitte Report focused on a specific aspect of this complex area as it relates to the Province of Ontario's accounting for the Ontario Teachers' Pension Plan (OTPP).

OTPP is a pension plan that is jointly sponsored by the Ontario government (or the Province) and the Ontario Teachers' Federation (OTF). Based on the Province's application of PSAS, OTPP is in a plan surplus position. We accepted this aspect of the Province's application of PSAS as a matter of fact in developing our report.

The Deloitte Report addressed the question of whether it was possible to record a pension asset related to the plan surplus in the Province's financial statements, given that the plan is jointly sponsored. We concluded that, based on the information provided to us by the Province and our professional judgement, that it was permissible under PSAS to record a pension plan asset, even though the Province's ability to benefit from any plan surplus, through future contribution reductions for example, would need to be negotiated with and agreed between the Province and OTF.

It is to be noted that even if a pension asset is recorded, PSAS would also require that consideration should be given to limiting the recorded amount of this pension asset to an amount that would be less than the calculated amount of the pension surplus. The Deloitte Report did not express a view on whether any limit to the recorded amount of the asset is needed in the case of the Province's accounting for the pension asset related to OTPP. Therefore, our report did not express a view on the amount of the pension asset that should be recorded in the Province's financial statements as at March 31, 2016 or at any other date.

Appendix B – EY Analysis of Valuation Allowance for OTPP and OPSEUPP

[under development]