Qs & As

Communications Branch
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Auditor General's Response to the 2018 Pre-Election Report

Updated: April 25, 2018

Key Messages

- The Pre-Election Report on Ontario's Finances, introduced in 2007, was the first of its kind in Canada, and today remains one of only a few such documents in the world.
- The purpose of the 2018 Pre-Election Report on Ontario's Finances is to outline the province's estimated revenues and expenses and other details of the fiscal plan before the start of the Ontario general election.
- The province is committed to providing clear and accurate financial reports that support transparency and accountability in reporting to the public and the legislature.
- We appreciate the work of the Auditor General in ensuring the public receives an independent assessment of the province's finances in advance of the next Ontario general election.
- The Auditor General concludes that the report is not a reasonable presentation of Ontario's finances because of the accounting treatment of the net pension assets of the two jointly sponsored pension plans and use of rate-regulated accounting for the component of the Fair Hydro Plan that is recoverable from the ratepayer.
- The difference of opinion in accounting treatment on net pension assets and the Fair Hydro Plan are not new issues – the disagreement on pension accounting was previously reported by the Auditor General in her audit opinions on the Public Accounts and the disagreement on the accounting for the Fair Hydro Plan was reported in her Special Report on the Fair Hydro Plan released in the fall of 2017
- It is important to note that with the exception of the two accounting disagreements, the Auditor General determined the Auditor General's determination that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.
- Ontario's fiscal policy is based on cautious assumptions and recognizes the need for flexibility to respond to changing circumstances. During this period of rapid economic change, the fiscal plan considers the impact of today's choices on different groups

within the province and on future generations.

Questions and Answers

Reliability of Financial Statements

1. **How can we trust your financial statements when their reliability is repeatedly called into question by independent officers of the legislature?**

- The province has the utmost respect for all independent officers of the legislature, and values the important perspective they bring.
- It is important to note the Auditor General's determination that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.
- The difference in opinion with the Auditor General on the accounting treatment for net pension assets and the Fair Hydro Plan, which are the basis for the conclusion by the Auditor General that the Pre-Election Report is not a reasonable presentation of Ontario's finances, are not new
- Ontario's fiscal policy is based on cautious assumptions and recognizes the need for flexibility to respond to changing circumstances. During this period of rapid economic change, the fiscal plan considers the impact of today's choices on different groups within the province and on future generations.
- We are committed to providing clear and accurate financial reports that support transparency and accountability in reporting to the public, the legislature, and other users.

2. **The Auditor General says that the Pre-Election Report is not a reasonable presentation of the province's finances due to the understatement of deficits from net pension assets and the Fair Hydro Plan. How do you respond?**

- We appreciate the work of the Auditor General in ensuring the public receives an independent assessment of the province's finances in advance of the next general election.
- It is important to note the Auditor General's determination that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.
- The province is committed to providing clear and accurate financial reports that support transparency and accountability in reporting to the public and the legislature.

- In developing Ontario's Fair Hydro Plan (OFHP), the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.
- The impact of the Fair Hydro Plan is transparently disclosed in the December 31, 2017 financial statements of the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG), which have been released with unqualified (or clean) audit opinions from their external auditors. It will also be transparent in the consolidated financial statements of the province, which will be released in Public Accounts later this year.
- With regards to the matter of net pension assets, the government has completed its research, which is supplemented by accounting opinions and advice of expert accountants and actuaries as well as the results of an expert panel's report on the topic.
- The province has a strong track record of producing clear and accurate financial reports, and we will continue to move forward and present the province's finances fairly and accurately and in accordance with Public Sector Accounting Standards (PSAS).

Province's Fiscal Situation

3. Do you think that the Pre-Election Report provides an accurate picture of the province's finances?

- Yes. We are committed to providing clear and accurate financial reports, like the Pre-Election Report, that support transparency and accountability in reporting to the public, the legislature, and other users.
- The purpose of the 2018 Pre-Election Report on Ontario's Finances is to outline the province's estimated revenues and expenses and other details of the fiscal plan before the start of the Ontario general election.
- The province's financial statements are prepared in accordance with Canadian Public Sector Accounting Standards (PSAS).
- The 2018 Pre-Election Report presents the three fiscal years (2018-19 to 2020-21) covered in the Budget's medium-term fiscal outlook.
- The report includes details of the government's medium-term fiscal plan. The medium-term fiscal plan is based on government policy decisions and direction, as well as estimates built on reasonable assumptions at the time it is developed.

4. The Auditor General's math shows that there is a hidden deficit on the books – nearly twice as much as the government has said. How can we believe your financial statements?

- The difference between the Office of the Auditor General and the government's with regards to the accounting treatment for net pension assets and Ontario's Fair Hydro Plan results in a difference in the computation for the projected deficit for the fiscal years presented in the 2018 Pre-Election Report
- The province has the utmost respect for all independent officers of the legislature, and values the important perspective they bring.
- It is important to note that with the exception of the disagreement on the accounting for net pension assets and the Fair Hydro Plan, the Auditor General determined that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.
- Ontario's fiscal policy is based on cautious assumptions and recognizes the need for flexibility to respond to changing circumstances. During this period of rapid economic change, the fiscal plan considers the impact of today's choices on different groups within the province and on future generations.
- The province's financial statements are prepared in accordance with Canadian Public Sector Accounting Standards (PSAS).
- The province has a strong track record of producing clear and accurate financial reports, and we will continue to move forward and present the province's finances fairly and accurately and in accordance with PSAS.

5. How can you say that the province includes prudence and flexibility in its fiscal management when just months after announcing a balanced budget, there is a plan to go back into a deficit of almost $7B?

- The Fiscal Transparency and Accountability Act, 2004 (FTAA), sets out the governing principles requiring Ontario's fiscal policy to be based on cautious assumptions and to recognize the need for flexibility to respond to changing circumstances.
- The fiscal plan reflects the government's policy decisions.
- Prudence is built into the fiscal forecast in a number of ways, including the reserve, the contingency funds and the use of economic planning assumptions that are slightly below the average of private-sector forecasters for Ontario real GDP growth, which are used to estimate revenue
- As required under FTAA, the fiscal plan incorporates prudence in the form of a reserve to protect the outlook from adverse changes in the Province's revenue and expense forecasts. The reserve has been set at $0.7 billion in each year between 2018–19 and 2020–21 and over the recovery plan period. The annual amount of the reserve is higher relative to the 2017-18 and 2018-19 reserves included in the 2017 Budget. The level of the reserve balances confidence that the economy is performing well while also acknowledging challenges ahead such as trade uncertainty with the United States, rising interest rates and increased household debt.

- Since FTAA was introduced in 2004, - with the exception of two recession years - the government has not needed the reserve to meet its fiscal targets.
- In addition to the reserve, the current outlook also maintains contingency funds to help mitigate expense risks – particularly in cases where health and safety may be compromised, services to the most vulnerable are jeopardized, or in the event of natural disasters – that may otherwise negatively impact Ontario's fiscal.
- Furthermore, in keeping with sound fiscal practices, the Province's revenue outlook, which incorporate economic planning assumptions, and forecasts for interest on debt are based on reasonable assumptions. The Ministry of Finance economic planning assumptions are slightly below the average from private-sector forecasters for Ontario real GDP growth. Three economic experts reviewed the 2018 Budget economic assumptions and found them to be reasonable.

6. Ontario is the most indebted sub-sovereign jurisdiction in the world. Interest on debt payments are increasing by at least five per cent every year – a higher than average growth compared to health and education spending. If you had responsibly managed finances, we could direct this money to programs Ontarians need the most – rather than continuing to go further and further into debt. How can you justify this reckless fiscal management?

- Since 2014, Ontario's economy has grown more than all G7 countries. Ontario's economy continues to perform well in an increasingly challenging global environment.
- All forecasters expect that Ontario's economy will continue to grow, but at a more modest pace. The government is making strategic investments in programs and services that will help support economic growth.
- As a result, beginning in 2018-19, the province is projecting modest deficits of less than one per cent of GDP.
- While the forecast deficits will contribute to the increase in net debt, it also increases due to projected investments in capital infrastructure that help economic growth. As a result, Ontario's net debt-to-GDP will remain below its 2014-15 peak of 39.3 per cent and resume a downward trend in 2022-23.The government is projecting a return to balance by 2024-25 and is committed to a recovery plan that will continue to take a balanced approach of investing and supporting key programs and services for Ontarians, and keeping the province's finances on a sustainable footing.
- Also, Interest-on-Debt-to-revenue, a key measure of the affordability of debt, has declined significantly over time.
- For example, in the year 2000, Ontario was paying about 15.5 cents of every dollar of revenue to service the province's debt. In 2017-18, Ontario is only paying eight cents – the lowest level in over 25 years. That ratio is predicted to remain in this range over the next three years.

7. **The AG points out the debt per every Ontarian will increase to $26,000 by 2021-22. Why does this government continue to spend at the expense of future generations?**

- The government recognizes there are risks to Ontario's economic outlook – an aging population, rising interest rates, and increasing household debt.
- More recently, the potential for changes to NAFTA and other protectionist measures could disrupt trade patterns, and tax reform underway in the United States could lessen Ontario's competitiveness.
- The government's investments in infrastructure in particular will contribute to the growth of the provincial economy. A recent report from the Centre for Spatial Economics confirms that over the long term, real GDP in Ontario increases by $6 for every dollar of public infrastructure spending.
- This stimulus in GDP may help to offset the effects of an aging population and slower growth in the labor force.

8. **The government is paying an enormous amount of money just paying the interest on its debt. How are you addressing this?**

- Interest-on-Debt-to-revenue, a key measure of the affordability of debt, has declined significantly over time.
- For example, in the year 2000, Ontario was paying about 15.5 cents of every dollar of revenue to service the province's debt. In 2017-18, Ontario is only paying eight cents – the lowest level in over 25 years. That ratio is predicted to remain in this range over the next three years.
- To reduce risks and save on interest on debt costs, the government has capitalized on the province's ability to raise funds at historically low interest rates. Over the last eight years, the government has issued over $70 billion of bonds with terms of longer than 30 years to lock in low rates, and to protect the province from rising interest rates.
- The Office of the Auditor General, in its review of the Pre-Election report, confirms that the assumptions underlying the Interest on Debt projections over the Budget outlook are reasonable.

9. **The province is already spending massive amounts just on interest on debt – not even paying off principal amounts. What if interest rates rise again?**

- To protect the province from rising interest rates, the government has focused on issuing bonds with terms of longer than 30 years over the last eight years. As a result, the average term of Ontario's debt portfolio has been extended, from 9.7 years in 2009–10 to 10.9 years as of December 31, 2017.

- Forecasters anticipate that long-term interest rates will rise over the next several years. The Interest-on-Debt projections in the 2018 Budget are based on prudent assumptions that take into account the forecast rise in interest rates.
- The Office of the Auditor General, in its review of the Pre-Election report confirms that the assumptions underlying the Interest on Debt projections over the Budget outlook are reasonable.

10. The Financial Accountability Officer has said in the past that your debt reduction commitments are based on unrealistic assumptions. You base a lot of projections on optimistic assumptions about Ontario's growth. Are your projections realistic and sustainable?

- A wide range of assumptions and planning tools help build prudence into Ontario's fiscal plan, including:
    - Estimated revenue, starting with the assumption that economic performance will be slightly lower than expected, as a margin of caution;
    - Contingency funds in each year to help mitigate risks that might otherwise have a negative impact on results; and
    - A reserve in each year to protect against unexpected and adverse changes in the Province's revenue and expense outlook.
- The government has beaten its fiscal targets every year since the recession. By overachieving on its fiscal targets, the province's accumulated deficit is projected to be $36.2 billion lower relative to annual forecasts.
- The Ministry of Finance economic planning assumptions are slightly below the average from private-sector forecasters for Ontario real GDP growth. Three economic experts reviewed the 2018 Budget economic assumptions and found them to be reasonable.

Personal Income Tax

11. The Auditor General states that you are over-estimating expected revenue from personal income tax. How do you respond?

- The Auditor General of Ontario has reviewed the province's revenue projection and concluded it is reasonable.
- The revenue projection is based on prudent economic assumptions that have been reviewed by three external expert economists who found them to be reasonable.
- We have a minor difference of opinion regarding the forecast of Personal Income Tax revenues in 2018-19, which amounts to a very small portion of the overall revenue forecast – at most 0.2 per cent.

12. Are you concealing the true cost of Ontario's Fair Hydro Plan? How can we trust this government's financial statements?

- The province's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS).
- The debt borrowed directly by the province is included in the gross debt of the province in the same way that all other debt issued by the province is recorded.
- The debt issued by either the Fair Hydro Trust or Ontario Power Generation (OPG) is recorded on the consolidated financial statements of OPG. The net assets of OPG are reported as a single line in the province's consolidated financial statements as part of the government's investments in government business enterprises. Condensed supplementary financial information of OPG and other government business enterprises are included in the Public Accounts.
- The method used to record OPG in the consolidated financial statements of the province is the same method that has been used since the Province began recording its investment in OPG since 2000.
- The impact of the Fair Hydro Plan is transparently disclosed in the December 31, 2017 financial statements of the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG), which have been released with unqualified (or clean) audit opinions from their external auditors. It will also be transparent in the consolidated financial statements of the province, which will be released in Public Accounts later this year.

13. Is your accounting structure for the Fair Hydro Plan an example of fraud?

- No. The province's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS).
- In developing Ontario's Fair Hydro Plan (OFHP), the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.
- All Chartered Professional Accountants (CPAs), including those employed by the Ontario Public Service (OPS), are required to comply with the Code of Professional Conduct for CPAs. One of those rules is that they not be associated with false or misleading information.
- The impact of the Fair Hydro Plan is transparently disclosed in the December 31, 2017 financial statements of the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG), which have been released with unqualified (or clean) audit opinions from their external auditors. It will also be transparent in the

consolidated financial statements of the province, which will be released in Public Accounts later this year.

Pension Asset Accounting

14. Why do you continue to disagree with the Auditor General on the pension asset accounting issue?

- The province continues to move forward and present the province's finances fairly and accurately and in accordance with Canadian Public Sector Accounting Standards (PSAS).
- Support for the government's accounting position includes:
    - The conclusions reached by an independent Pension Asset Expert Advisory Panel (the 'Panel'), comprised of accredited accounting, actuarial and legal professionals with extensive background in pension accounting and plan governance.
    - An opinion from Deloitte LLP on aspects of the Province's accounting as at March 31, 2016 for the Ontario Teachers' Pension Plan. The opinion, which was dated October 2, 2016, concluded that it was permissible to recognize a pension asset under Canadian Public Sector Accounting Standards, even though the Province did not have under a unilateral right to reduce contributions. The opinion did not address the value at which the asset should be recorded.
    - 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.
- PSAS neither requires unilateral control to record an asset, nor does it include a requirement to obtain a letter from the co-sponsor of the plan agreeing to reduce further contributions within 12 months.
- The province will evaluate the need for a valuation allowance annually taking into consideration (a) changes, if any, in the governance structures of the plans, (b), decisions, if any, of the joint sponsors that impact the need for a valuation allowance, and c) changes, if any, in PSAS.
- The province is open to continuing discussions in the hopes of resolving this matter.

Audit Opinions

15. Are you concerned that the Auditor General may issue an adverse opinion on the province's consolidated financial statements, given her reaction to the Pre-Election Report?

- It is important to note that with the exception of the accounting disagreements related to the net pension assets of the jointly sponsored pension plan and the use of rate-regulated accounting to account for a component of the Fair Hydro Plan, Auditor General's determination that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.

- It would be inappropriate to speculate about how the Auditor General may issue an opinion for the 2017-18 Public Accounts.
- The province has a strong track record of producing clear and transparent financial reports, and we will continue to move forward and present the province's finances fairly and accurately and in accordance with Public Sector Accounting Standards (PSAS).
- The province has the utmost respect for all independent officers of the legislature, and we value the important and necessary perspective they bring. We will continue to work closely with the Office of the Auditor General to identify audit issues early and to ensure that stakeholders are engaged in discussions regarding risks and resolution.

16. Can the Auditor General issue a qualified opinion on the Pre-Election Report?

- The *Fiscal Transparency and Accountability Act* require the Auditor General of Ontario to review the pre-election report and issue a statement – not an audit opinion – on the results of that review.
- It is important to note that with the exception of the accounting disagreements related to the net pension assets of the jointly sponsored pension plan and the use of rate-regulated accounting to account for a component of the Fair Hydro Plan, the Auditor General's determination that the majority of the province's estimates regarding revenue, program expenses and interest on debt are based on cautious assumptions, as required by the Fiscal Transparency and Accountability Act.

17. Other Auditors General agree with how the Ontario Auditor General has characterized the issues with the province's finances. How do you respond?

- The province has the utmost respect for all independent officers of the legislature, and we value the important and necessary perspective they bring.
- Public Sector Accounting Standards (PSAS) are principle based – they are not a set of specific prescriptive rules. Applying them requires the application of professional judgment.
- All Chartered Professional Accountants (CPAs), including those employed by the Ontario Public Service (OPS), are required to comply with the Code of Professional Conduct for CPAs. One of those rules is that they not be associated with false or misleading information.
- That means that if the professional accountants in the OPS do not agree with the judgment of the Ontario Auditor General, it is not as simple as agreeing to accept the

interpretation of the Office of the Auditor General if they believe that interpretation would result in false or misleading financial statements.

- While we expect professional accountants to agree on the vast majority of issues, we acknowledge that they may not agree on everything and when that occurs, and the difference is material to the financial statements, the Office of the Auditor General can choose to issue a qualified audit opinion.

- The province has a strong track record of producing clear and transparent financial reports, and we will continue to move forward and present the province's finances fairly and accurately and in accordance with PSAS.

Relationship with the Auditor General

18. Did the government cooperate with the Office of the Auditor General for their review of the Pre-Election Report?

- The purpose of the 2018 Pre-Election Report on Ontario's Finances is to outline the province's estimated revenues and expenses and other details of the fiscal plan before the start of the Ontario general election.

- The province's professional staff works closely and constructively with the Office of the Auditor General on a number of matters, including the Pre-Election Report.

- Staff of Treasury Board Secretariat and the Ministry of Finance proactively worked with the Office of the Auditor General since early December to engage in planning and preparatory work for the development of the Pre-Election Report. Staff has been working over the past number of months to provide information and details to support the Office of the Auditor General's review of the Pre-Election report.

- The province continues to engage all officers of the legislature to engage constructively to ensure the people of Ontario are provided with an independent review of the Province's fiscal position in advance of the election.

19. Why do you continue to disagree with the Auditor General?

- The province has the utmost respect for all independent officers of the legislature, and we value the important and necessary perspective they bring.

- Public Sector Accounting Standards (PSAS) are principle based – they are not a set of specific prescriptive rules. Applying them requires the application of professional judgment.

- All Chartered Professional Accountants (CPAs), including those employed by the Ontario Public Service (OPS), are required to comply with the Code of Professional Conduct for CPAs. One of those rules is that they not be associated with false or misleading information.

- That means that if the professional accountants in the OPS do not agree with the judgment of the Ontario Auditor General, it is not as simple as agreeing to accept the interpretation of the Office of the Auditor General if they believe that interpretation would result in false or misleading financial statements.
- While we expect professional accountants to agree on the vast majority of issues, we acknowledge that they may not agree on everything and when that occurs, and the difference is material to the financial statements, the Office of the Auditor General can choose to issue a qualified audit opinion.
- The province has a strong track record of producing clear and transparent financial reports, and we will continue to move forward and present the province's finances fairly and accurately and in accordance with PSAS.

Contingency Fund

20. Why is the Contingency Fund being increased by $1 billion in 2018-19?

- The government has taken measures to ensure an appropriate level of prudence and flexibility is built into the fiscal plan.
- The fiscal plan includes contingency funds (both operating and capital) to help mitigate expense risks, particularly in cases where health and safety may be compromised or services to the most vulnerable are jeopardized, that may otherwise adversely affect Ontario's fiscal performance.
- The contingency fund levels are reset annually through the multi-year planning process, taking into consideration factors such as expense risks and other elements of the budget (e.g. the level of reserve).
- From 2008-09 to 2017-18, the total Contingency Fund allocation has ranged from $500 million up to $3.4 billion. As such, the 2018-19 Contingency Fund allocation of $1.6 billion is within its historic range.

Consolidated Income Statement

21. The Auditor General says you didn't provide a consolidated income statement like you were supposed to. Why?

- We believe that all the information to form such a statement is available in the PER. these details can be found in Tables 1, 5 and 7 of the Report released on March 28, 2018.
- We have also prepared a consolidated statement as readers may find the compilation of this information into one table useful. It is available on Ontario.ca alongside the 2018 Pre-Election Report.