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Office of the Provincial Controller Division

Public Accounts Overview

Transition Briefing

June 7, 2018

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FOR DISCUSSION PURPOSES ONLY

Overview

- The *Financial Administration Act* defines the components of the Public Accounts and requires the release on or before the 180th day following the end of the fiscal year (generally September 27).
- Historically the province has used Canadian Public Sector Accounting Standards as the basis of measurement and reporting to ensure consistency, comparability and transparency with other senior Canadian governments
- Treasury Board Secretariat, Office of the Provincial Controller collects, reviews, reconciles and compiles the financial information from all ministries and controlled entities, including supplemental note disclosures and schedules, to produce the consolidated financial statements, and prepares a discussion and analysis report to explain the results
- The Office of the Auditor General of Ontario audits the consolidated financial statements of the Province in accordance with Canadian auditing standards and issues an opinion thereon

Assurance on Financial Reporting

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- All ministries attest they have an effective system of internal controls to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable legislation, regulations, directives and policies, the effectiveness of ministry operations and applied appropriate oversight to safeguard the Province's assets. Board-governed agencies also provide an attestation to their respective ministry.

- The ministry attestations support the Provincial Controller's sign off on the Statement of Responsibility for the Consolidated Financial Statements of the Province of Ontario.

- Agencies and Broader Public Sector entities assessed as controlled by the Province are consolidated where material to the consolidated financial statements (>$50 million revenues, expenses, assets, liabilities)
  - <u>Audited</u> financial statements of these organizations are included in the consolidated financial statements of the Province (assurance is provided by an external auditor).
    - Expenses of consolidated entities that are separately audited accounted for approximately 45% of the $141.7 billion in total expenses reported in 2016-17

- The Office of the Auditor General directly audits the balance of the consolidated financial statements, issuing an opinion on the consolidated financial statements of the Province

Public Accounts

- The audit opinion on the Province's 2016-17 consolidated financial statements included two qualifications[1] by the Auditor General related to:

    1. Pension accounting; and

    2. Reporting the market accounts of the Independent Electricity System Operator.

- Additionally, as a result of proposed reporting of the Global Adjustment Refinancing (a component of the plan to reduce current electricity prices), the Auditor General has indicated that she may issue an adverse opinion[2] on the 2017-18 financial statements.

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[1] A qualified opinion means that the auditor agrees that the financial statements are fairly presented, except for those items noted.

[2] An adverse opinion means the auditor believes that the misstatements in the financial statements are both material and pervasive, and are not fairly stated.

Pension Accounting Overview

- The Government of Ontario is a co-sponsor of two jointly sponsored pension plans -- Ontario Public Service Employees Union Pension Plan and Ontario Teachers' Pension Plan. 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.
- Under the accounting framework a net pension 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 net pension assets reflected on the audited consolidated financial statements of the Province has been based on a policy consistent with Canadian Public Sector Accounting Standards for retirement benefits.
- The accounting standards have not changed since their issuance in 2001. The issue was first raised by the Auditor General in 2016.

Support for Pension Accounting Treatment

- The professional staff's interpretation of Canadian Public Sector Accounting Standards is supported by staff research and analysis as well as:
  - A report from 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 on aspects of the Province's accounting as at March 31, 2016 for the Ontario Teachers Pension Plan. The opinion, dated October 2, 2016, concluded it was permissible to recognize a pension asset under Canadian Public Sector Accounting Standards, even though the Province did not have a unilateral right to reduce contributions.
  - Analysis completed by Ernest and Young as to whether any valuation allowance is required to be recorded for either pension plan as of March 31, 2017 and as of March 31, 2018 confirmed no valuation allowance was required for either plan.
- 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 noting that the deficit was understated in 2016-17 by $1.4 billion and the net debt and accumulated deficit was understated by $12.4 billion.

Pension Accounting – Potential Options

- A discussion with the Office of the Auditor General is planned to re-examine the Ontario Public Service Employees Union Pension Plan before the issuance of 2017-18 Public Accounts in an effort to resolve this issue.
- Resolution regarding the Ontario Teachers Pension Plan would require the government to commence dialogue with the Ontario Teachers' Federation – the other co-sponsor of the plan regarding:
  1. Allocating any surplus in the plan to the co-sponsors and provide for independence with respect to decision making on the surplus – supports continuing to record asset;
  2. Working with Ontario Teachers Federation to proceed with an additional reduction in contributions if plan performance supports such action (as of January 1, 2018, contributions were reduced by 1.1%) – supports continuing to record asset;
- Options 1 and 2 would require the agreement of Ontario Teachers Federation and would resolve the issue if the Auditor General agrees the changes support recognition of the net pension asset.
  3. Amending the governance of the Ontario Teachers Pension Plan to remove the government's ability to participate in decision-making regarding the use of any surplus in the plan (for example, decisions regarding contributions and benefits) – would result in fully writing off the net pension asset.
- Option 3 also requires agreement of the Ontario Teachers Federation and results in a significant reduction in the role of the Province in the governance of the plan while maintaining the government's financial obligations.

Market Accounts – Overview

- The Independent Electricity System Operator administers a $17 billion annual market reflecting the amounts *due to* entities providing electricity to the market (e.g. power generators) and *due from* entities consuming electricity (e.g. local distribution companies on behalf of their consumers). Referred to as market accounts.
- In 2016, the accounting for the market accounts was changed recognizing these amounts due from and due to the market participants as assets and liabilities respectively. This change has no impact to the province's annual deficit, net debt or accumulated deficit.
- The Independent Electricity System Operator management, their Audit Committee, their Board of Directors, their external auditor and the Office of the Provincial Controller support the change in accounting as being more transparent.
- 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.

Market Accounts – Potential Options

- In reviewing any change in policy direction, some of the accounting considerations to resolve the reporting of the market accounts include:
  - The adoption of a provincial accounting policy to adjust the Independent Electricity System Operator financial statements and remove the market accounts (and any rate-regulated) balances from the consolidated financial statements;
  - The review of the accounting classification of the Independent Electricity System Operator; assessing if it can be classified as a Government Business Entity or a Trust Under Administration (reported under International Financial Reporting Standards), which would change the reporting.

Fair Hydro Plan – Global Adjustment Refinancing

- The only component of the Fair Hydro Plan that is the subject of dispute with the Auditor General is the Global Adjustment Refinancing.
- The difference between the Province's accounting for the Global Adjustment Refinancing and that of the Auditor General is based on differing opinions on the application of rate-regulated accounting under Canadian Public Sector Accounting Standards.
- The standards are silent on the recognition, measurement, presentation and disclosure of rate-regulated activities. In absence of a clear position on an issue, accounting standards require consultation of other accounting frameworks.

Potential Option

- The following policy decisions would impact the accounting for the Global Adjustment Refinancing and should eliminate the accounting dispute:
  - Amend *Ontario Fair Hydro Plan Act* to remove the debt recovery from future ratepayers through the Clean Energy Adjustment, thus providing a permanent rather than temporary reduction. The lack of a recovery mechanism would result in the impact of the reduction from the Global Adjustment Refinancing being recorded as an increase to the annual deficit; and
  - Amend the terms of the trust agreements with the Financial Services Manager of the Fair Hydro Plan Trust (currently Ontario Power Generation) to bring the Fair Hydro Plan Trust under the direct control of the Province requiring the debt to be consolidated as a government organization.
- Both policy changes would be required to eliminate the accounting dispute.