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Office of the Provincial Controller Division

Accounting Overview

Transition Briefing

June 7, 2018

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FOR DISCUSSION PURPOSES ONLY

Overview [Placeholder - Mark]

- how accounting for government works
  - PSAS
  - CoA [Tiffany]
  - Consolidated entities audits
  - Role of OPCD, AG

Public Accounts

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

  1. Pension accounting; and

  2. Reporting the market accounts of the Independent Electricity System Operator (IESO).

- Additionally, as a result of proposed reporting of the Global Adjustment Refinancing (a component of the Fair Hydro Plan to reduce current electricity prices), the AG 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 (e.g. pension accounting and recording market accounts for the IESO).

[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

- 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.
- Under PSAS, 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 net pension assets reflected on the audited consolidated financial statements of the Province has been based on a policy consistent with PSAS related to accounting for retirement benefits.
- The accounting standards have not changed since their issuance in 2001. The issue was first raised by the AG in 2016.

Support for Pension Accounting Treatment

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- The professional staff's interpretation of PSAS 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 on aspects of the Province's accounting as at March 31, 2016 for the OTPP, a summary of which is included in Appendix A. 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.
  - Analysis completed by EY as to whether any valuation allowance is required to be recorded for OTPP or OPSEUPP as of March 31, 2017 and as of March 31, 2018. EY 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 of OTPP and OPSEUPP, 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 OAG is planned to re-examine the OPSEUPP before the issuance of 2017-18 Public Accounts in an effort to resolve this issue, however, the more significant component of this issue is related to OTPP.
- Resolution regarding OTPP would require the government to commence dialogue with the Ontario Teachers' Federation on changes to the governance of the pension plan. These discussions could take the form of:
  1. Allocating any surplus in the plan to the co-sponsors and provide for independence with respect to decision making on the surplus (similar to OPSEUPP) – supports continuing to record asset;
  2. Working with OTF 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 OTF and would only resolve the issue should the AG agree that these changes support recognition of the net pension asset.
  3. Amending the governance of the OTPP to remove the government's ability to participate in decision-making regarding the use of any surplus in the plan (e.g. decisions regarding contributions and benefits) – would result in fully writing off the net pension asset.
- Option 3 results in a significant reduction in the role of the Province in the governance of the plan.

Market Accounts – Overview

- IESO administers a $17 billion annual market reflecting the amounts *due to* entities that provide electricity to the market (e.g. power generators) and *due from* entities who consume electricity (e.g. local distribution companies on behalf of their consumers). IESO is a party to these agreements with the market participants.
- In 2016, IESO changed the accounting for the market accounts, 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.
- IESO 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 IESO financial statements and remove the market accounts (and any rate-regulated) balances from the consolidation financial statements;
  - The review of the accounting classification of the IESO; 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 of the IESO.

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 AG is based on differing opinions on the application of rate -regulated accounting under PSAS.
- PSAS is silent on the recognition, measurement, presentation and disclosure of rate-regulated activities. In absence of a clear position on an issue, standard accounting practice dictates that an entity should consult other accounting standards.

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 OPG) to bring the Fair Hydro Plan Trust under the direct control of the Province requiring the debt to be consolidated as a government organization (line-by-line)
- Both policy changes would be required to eliminate the accounting dispute.