TBS Briefing Note

Office of the Provincial Controller Division
Financial Management & Control Policy Branch

Public Accounts Management Representation Letter

Objective:

The purpose of this memorandum is to identify key areas of improvement in support of the sign-off of the Auditor General's management representation letter (MRL) for 2016-17 Public Accounts.

The scope of our review and recommendations is based on the 2015-16 MRL.

Risk, Implication & Recommendation

MRL 1 & 4: As part of the Certificate of Assurance (CoA), ministries, including board-governed agencies, attest to maintaining an effective internal control system, designed to provide reasonable assurance regarding the reliability of financial reporting. The self-assessment performed by ministries/consolidated agencies as part of this process may result in failure to detect significant control deficiencies.

Recommendation: Independent testing, auditing and assessments of Internal Control over Financial Reporting should be performed by Ontario Internal Audit Division (OIAD); objective personnel should provide assurance that risk responses are consistently implemented, procedures are understood and followed, and appropriate controls are in place.

MRL 1 & 4: As part of the annual Public Accounts reporting process, ministries are required to report their actual financial results on a consolidated basis and therefore include the financial activities of consolidated organizations. To assist ministries with this process, the Office of the Provincial Controller Division (OPCD) prepares a number of financial reporting templates for ministries and their consolidated organizations to complete. While ministries are responsible for overseeing the process with their consolidated organizations, including ensuring the completion and validation of all required templates, lack of management review and monitoring of staff work at OPCD may result in inaccurate financial reporting.

Recommendation:

- OPCD should develop and maintain documentation of Internal Control over Financial Reporting. Documentation of controls, including changes to controls, is evidence that controls are identified, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated.
- Evaluate and document the results of continuous monitoring. That is, management should monitor (on ongoing or periodic basis) to ensure all due diligence steps and controls are performed by staff as required.
- OPCD Management should sign-off to demonstrate their review of the prepared documents for validity, accuracy, completeness. Management review and approval should be considered for the following processes:
    - Consolidation process – BPS and non-BPS organizations
    - Preparation of the Consolidated Financial Statements (Annual Report, Volume 1, 2 and 3)
    - Pension accounting process – calculation of actual expense and liability

MRL 8: The consolidated financial statements properly disclose the nature and extent of related party transactions and contain a description of the relationship with the related parties, the amounts due to or from related parties, and, if not otherwise apparent, the terms of settlement. Related Party Disclosures standard is in effect April 1, 2017. While, Related Party Disclosures standard does not impact 2016-17 Consolidated Financial Statements, there is a risk that ministries may not have sufficient guidance early on to effectively implement the standard for 2017-18 Public Accounts.

Recommendation:

- 2017-18 Certificate of Assurance has been updated, requiring ministries and consolidated agencies to attest to;
    - Ministries: all applicable related party transactions including sales, purchases, loans, transfers, leasing arrangements and guarantees, and amounts received from or payable to related parties have been appropriately measured and disclosed, including non-monetary transactions and transactions for no consideration. There have been no exchanges of goods or services with any related party for which appropriate accounting recognition and disclosure has not been given.
    - Consolidated Agencies: agency related party transactions will be available in their Audited Financial Statements.
- Accounting Policy and Financial Reporting unit should work closely with the impacted stakeholders to understand the challenges imposed by this standard as soon as possible. Sufficient tools/resources/guidance should be developed to support ministries with their data collection efforts, so that enterprise-wide data collected for 2017-18 Public Accounts is accurate, complete and consistent across the organization.

MRL 13: The Province uses derivative products to hedge exposure to currency and interest rate fluctuations and has adequate policies and procedures in place to limit risk exposure. Government's derivative process is managed by the Ontario Financing Authority (OFA), outside of OPCD. As such, there is a risk that the Province's derivatives activities are not properly accounted for and recorded in the financial statements in accordance with the stated accounting policies.

Recommendation:

- As part of the preparation of the Consolidated Financial Statements, OPCD should identify all significant processes that are managed by the OFA that has an impact on Public Accounts.
- An understanding of controls at the OFA relating to the derivative management should be developed.
- OPCD should monitor and assess OFA's practices through clear performance expectations/objectives and reporting requirements.
- In the short-term, OPCD should obtain a memo from the OFA, attesting that; the Province's derivatives activities have been properly accounted for and recorded in the financial statements in accordance with the stated accounting policies and the nature and risk associated with its derivatives activities has been properly disclosed in the notes to the financial statements.
- In the long-term, OPCD should work with the OFA to obtain similar assurance through the CSAE 3416, Reporting on Controls at a Service Organization.
    - CSAE 3416 is relevant to a situation when the service being provided to an organization impacts the user organization's financial reporting processes. In such situations, service organizations are often subjected to audits of these processes. If available, OPCD should obtain and review OFA's CSAE 3416 reports / similar type of audit reports to assess the type of review performed, the sufficiency of the review scope, and the results of the review. The report should include an opinion and the supporting results of detailed testing of the operating effectiveness of controls over a period of time, as well as information about the nature, timing, and extent of testing.

MRL 14: Employee future benefit obligations, costs and assets are determined, accounted for and disclosed in accordance with the requirements of PS 3250, Retirement Benefits (PS 3250) and PS 3255, Post-employment Benefits, Compensated Absences and Termination Benefits (PS 3255). The following key risks were highlighted in Auditor General's 2016 Annual Report, as well the 2015-16 Certificate of Assurance process;

- Difference of opinion between the government and the Auditor General in accounting of pension assets related to the jointly sponsored Ontario Teacher's Pension Plan and the Ontario Public Service Employees' Union Pension Plan.
- Inappropriate selection of economic assumptions to determine the pension liability and pension expense. As noted in the 2016 Auditor General's Annual Report, the discount rates are edging towards the high end of a reasonable range.

- Inadequate risk and control assessment around employee future benefit obligation process.

Recommendation:
- To inform the Province's accounting treatment for pension plans, the government has established an Expert Advisory Panel (Panel) that will provide advice on the interpretation of Public Sector Accounting Standards to the Province's net pension assets. The Panel's recommendations will inform the Province's final position paper on accounting for net pension assets, which will be shared with the Office of the Auditor General.
- Pension estimates and assumptions should be continuously assessed, considering historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.
    - Benchmark assumptions against respective Pensions boards' assumptions and review the economic assumptions for reasonableness.
    - Appropriate documentation should be developed, outlining the rational for the selected economic assumptions for the fiscal year.
    - Appropriate documentation should be developed for audit purposes on assumptions that are dedicated by the Public Sector Accounting Standards (i.e. discounts rates). The documentation should include a discussion on how the requirements established under the accounting standards are met.
- Risk Control Matrices should be developed to ensure risks are identified and managed appropriately around the pension process (i.e. calculation of pension expense and developing economic assumptions). Documented controls should be tested by OIAD to determine control effectiveness, on an annual basis.

MRL 16: All significant government agencies have been included in the Province's reporting entity. These significant agencies have been appropriately classified as organizations, enterprises, or trusts, and reflected in the financial statements via line by line consolidation, modified equity treatment, or disclosure of trust balances, respectively. Control assessment in accordance with PSAB requirements may not be performed by ministries on an annual basis, resulting in inappropriate inclusion/exclusion and/or classification of all significant government agencies in the Consolidated Financial Statements.

Recommendation: As part of Public Accounts instruction, OPCD should;
- Develop a standardized template, approved by the Finance Director, requiring ministries to perform control assessment for all agencies as required by PSAB to determine if an agency should be part of the Government Reporting Entity.
- Require ministries to review all their controlled government organizations that have historically been below consolidation thresholds to determine whether any of them have now met the Province's thresholds for consolidation.

- Develop a memo, providing confirmation that both points noted above have been performed, on an annual basis. Ministries should be required to return a director signed-off copy to OPCD as part of their Public Accounts submission package.

MRL 18 &19: The Province reflected the results of Ontario Power Generation (OPG) and Hydro One Limited (HOL) using US GAAP as a basis of accounting for 2015-16 Public Accounts. Consolidation of OPG and HOL based on US GAAP as opposed to IFRS as required by PSAB standards may result in material effect on the annual deficit in future fiscal years, potentially as soon as the 2016-17 fiscal year.

Recommendation: As recommended by the Auditor General in 2016 Annual Report, the Province of Ontario should consider including HOL and OPG financial information in the consolidated financial statements using the IFRS reporting framework as required by PSAB standards.

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Background

Overview

The Certificate of Assurance is an ongoing (annual) process that provides annual assurance to the Office of the Auditor General of Ontario (OAGO) that the government has a strong internal control framework. The CoA helps evaluate the effectiveness of controls and financial reporting standards, and therefore it is a critical tool used to obtain an unqualified audit opinion on the Public Accounts from the OAGO.

The CoA's scope has evolved to become a key component of the OPS Internal Control Framework to assess and provide ministries with an opportunity to:

1. Confirm that financial management, reporting and asset stewardship controls are in place and functioning effectively;
2. Identify the risks associated with controls along with related impacts and action plans to mitigate and correct the control weaknesses; and
3. Ensure full disclosure on the reliability and integrity of the financial records and resulting financial position of the Province.

More importantly, the CoA supports the publication of the Financial Statements of the Province of Ontario, provides needed transparency with financial management policies and practices, and embodies the Ontario Public Service financial management framework in accordance with relevant directives, policies, guidelines and instructions. The CoA attestation process has to be completed by all Ministries, Cabinet Office, Office of Francophone Affairs and Office of the Legislative Assembly.

Ministry Attestation Process

Ministries are required (as administered by the Office of the Provincial Controller's Division) to provide a signed memo (Certificate of Assurance Attestation) that provides assurance that, to the best of each Ministry's knowledge and belief, the Ministry has maintained a sound system of internal controls, kept proper financial records, ensured the integrity and reliability of its financial reports and applied appropriate oversight to safeguard the Public's assets and funds. More specifically;

- Their internal control systems are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for reporting purposes. The Ministry has reviewed the internal controls over financial reporting and concludes that they were effective in all material respects throughout the year ended March 31, 201x.

- The statements and schedules supplied by this Ministry in support of all financial reporting, including the Province's Public Accounts, have been prepared in accordance with the Summary of Significant Accounting Policies as stated in the 2014-15 Public Accounts and

2015-16 Public Accounts Instructions and Guidelines as issued by the Office of the Provincial Controller's Division.

- The Ministry is in substantial compliance with all legislative requirements pertaining to transactions with material financial impact to the Ministry and to the Province's financial statements and such transactions were recorded accurately in accordance with authorized legislation including the *Financial Administration Act (FAA).*
- The books and records contain all transactions with material financial impact on the Ministry and all such transactions are properly reported in accordance with reporting requirements of Public Accounts, Financial Directives, Policies, Practices, and Legal requirements in all substantial respects.
- Appropriate asset stewardship, recording and reporting is in place.
- Liabilities and potential liabilities have been recorded and reported as required.

Board-Governed Agency Attestation Process

Board-governed agencies are required (as administered by their respective ministries) to provide a signed memo that provides assurance that, to the best of their knowledge and belief, the Agency is in substantial compliance with all applicable legislation, regulations, directives, and policies; has maintained an effective system of internal controls; and has established and maintained a system of internal controls that supports the integrity and reliability of our financial reports. More specifically,

- The Agency internal control systems are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for reporting purposes. The Agency has reviewed the Internal Control over Financial Reporting (i.e. assets, liabilities, revenue and expenses) and concludes that they were designed appropriately and operating effectively to help mitigate financial reporting risks in all material respects throughout the year ended March 31, 2016.

- The statements and schedules supplied by the Agency in support of the financial reporting, have been prepared in accordance with applicable accounting standards (e.g. Public Sector Accounting Standards, Public Sector Accounting Standards + 4200 PSAB for Government NPOs, International Financial Reporting Standards or other provincially approved framework), legislation, and Instructions and Guidelines as issued by the Office of the Provincial Controller.

- The Agency is in substantial compliance with all applicable statutory requirements. These applicable statutes may include, but are not limited to, the Public Service of Ontario Act, Freedom of Information and Protection of Privacy Act, Adjudicative Tribunals Accountability, Governance and Appointments Act, Financial Administration Act, French Language Services Act and the Archives and Recordkeeping Act.

- The Agency is in substantial compliance with all legislative requirements pertaining to transactions with material financial impact to the Agency and to the Province's financial statements and such transactions were recorded accurately in accordance with authorized legislation including the Financial Administration Act.

- The books and records contained all transactions with material financial impact on the Agency and all such transactions are reported in accordance with applicable reporting requirements, directives, policies, and legislative requirements in all material respects.