CONFIDENTIAL REVISED: May 8, 2018

2016-17 PUBLIC ACCOUNTS

ISSUE: What is reported in the 2016-17 Public Accounts released on September 7, 2017?

KEY MESSAGES: PUBLIC ACCOUNTS

- The 2016-17 Public Accounts of Ontario show the province's deficit is $991 million.
- This result is $3.3 billion lower than projected in the 2016 Budget, and $0.5 billion lower than the interim forecast in the 2017 Budget.
- This is a result of growth in revenue that exceeded growth in program expense, and lower than forecast interest on debt.
- The province will continue to present the province's finances fairly and accurately and in accordance with Canadian Public Sector Accounting Standards.

KEY MESSAGES: OPEN GOVERNMENT

- To help Ontarians better understand their government's finances, new digital tools have been developed that present the Public Accounts data in innovative, visual formats. These tools make Ontario's finances easier to understand, access and use.
- Presenting the Public Accounts data in innovative, visual formats is part of Ontario's commitment to Open Government.

KEY MESSAGES: ACCOUNTING CHANGES

- When preparing the 2016-17 Public Accounts, Ontario's professional accounting staff adopted accounting changes:

1) **BROADER PUBLIC SECTOR (BPS) REVENUE PRESENTATION**

- The 2016-17 Public Accounts present third-party revenues for hospitals, school boards and colleges, such as tuition fees, patient fees, research grants and donations, 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 change increases total revenues and expenses by approximately $8 billion, and does not impact the deficit, net debt or accumulated deficit.
- This change is consistent with public sector accounting standards and the reporting practices of other senior Canadian governments.
- The Auditor General is supportive of this change in presentation.

2) **ACCOUNTING FOR ENERGY 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, as the difference in their results between US GAAP and IFRS was not material.
- This change does not have a material impact on the 2016-17 Public Accounts.
- The Auditor General is supportive of this change in presentation.

3) PENSION ACCOUNTING:

- The government established the Pension Asset Expert Advisory Panel following the release of the 2015-16 Public Accounts.
- The Panel delivered independent advice on how public sector accounting standards are interpreted as they apply to current net pension assets and the application of public sector accounting standards for two of Ontario's jointly sponsored pension plans: Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP).
- The Panel's report concluded that the province's share of the net pension assets of both the OTPP and the OPSEUPP should be recognized in Ontario's financial statements.
- The government accepted the Panel's recommendations, which have been reflected in the 2016-17 financial statements.
- The 2015-16 financial statements have also been restated to reflect the pension assets for these two plans.
- The accounting for these two plans is now consistently presented for all years going back to 2002.

- The Auditor General does not agree with this accounting treatment; for the 2015-16 and 2016-17 Public Accounts, the Auditor General issued a qualified audit opinion on this matter, stating that the province's deficit is understated by $1.4 billion in 2016-17.

4a) IESO ACCOUNTING: MARKET ACCOUNTS

- The province consolidates the entities it controls, in accordance with Public Sector Accounting Standards (PSAS) and its internal reporting policies.
- Each consolidated entity produces its own stand-alone financial statements and is subject to its own financial statement audit.
- In 2016, the Independent Electricity System Operator (IESO) changed the accounting for the market accounts and recognized these balances on its financial statements.
- 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.
- The financial statements of the IESO for the year-ended December 31, 2016 were subject to an external audit and received an unqualified (or clean) opinion.
- This change has an equal and offsetting impact to assets and liabilities of $1.65 billion, and no impact to the province's annual deficit, net debt or accumulated deficit.
- The Auditor General issued a qualified audit opinion in 2016-17 based on the recognition of the IESO's market accounts.

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4b) IESO ACCOUNTING: RATE-REGULATED ACCOUNTING

- The IESO made the decision to adopt rate-regulated accounting because it reflects the economic substance of certain types of expenses that may not be directly recovered through the normal revenue requirement model.

- The IESO management, IESO's Audit Committee, IESO's Board of Directors, IESO's external auditor and the Office of the Provincial Controller support the use of rate-regulated accounting by IESO.
- The consolidated financial statements of the province already reflect the impact of rate-regulated accounting through the accounting used for Ontario Power Generation (OPG) and Hydro One (H1). The income for both OPG and H1, reflected in the province's financial statements using IFRS, in determined using rate regulated accounting.
- Canadian PSAS are silent on the issue of using rate regulated accounting – they neither explicitly permit, nor prohibit, the recognition, measurement, presentation, or disclosure of rate-regulated activities.
- In the absence of a clear position on an issue, standard accounting practice dictates that an entity should consult other accounting standards. This guidance for PSAS is included in the Canadian Public Sector Accounting Handbook.
- In this case, the Independent Electricity System Operator (IESO) consulted U.S. Generally Accepted Accounting Principles (GAAP), the appropriate accounting framework in North America that provides guidance on accounting for rate-regulated operations.
- The Auditor General also noted in her 2016-17 audit opinion that the use of rate-regulated accounting under PSAS is not permitted, but did not qualify on the issue of rate-regulated accounting, as the impact was not material in the 2016-17 year.

RECENT PUBLIC SECTOR ACCOUNTING STANDARDS DEVELOPMENTS (2018 Budget):

- The government continues to provide input to the Public Sector Accounting Board (PSAB) on a number of initiatives, including PSAB's review of its conceptual framework, employment benefits such as pensions, accounting for financial instruments and foreign currency translation, and public-private partnerships.

- New accounting standards on foreign currency translation and financial instruments are effective for the 2021–22 fiscal year.
- The impact of these standards, if any, has not been reflected in the fiscal plan.
- The government will ensure its accounting and reporting are amended as required to implement the new standards, once finalized, on revenue and asset retirement obligations once those standards are issued.
- Users, including the legislature and the public, need accountability in government reporting and decision-making. As a result, it is essential that public sector financial statements reflect the substance of the government's activities.

KEY MESSAGES: STANDING COMMITTEE ON PUBLIC ACCOUNTS REVIEW AUDITOR GENERAL'S 2017 ANNUAL REPORT – CHAPTER ON PUBLIC ACCOUNTS (CHAPTER 2)

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- The government thanks the Auditor General for her recommendations, and remains committed to assisting the Office of the Auditor General in providing its independent views to the Legislative Assembly.
- The government's use of external expertise for accounting and financial reporting matters supplements its own resources on complex or emerging accounting and reporting matters.
- The province will continue to provide financial statements according to PSAS that support transparency and accountability in reporting to the public, the legislature, and other users.

CURRENT STATUS

- May 3, 2018 – The Standing Committee on Public Accounts (SCOPA) tabled their report on their review of Chapter 2 – Public Accounts of the Province, of the Auditor General's 2017 Annual Report. The report made two recommendations:
    - 1. Government accounting practices, and those of its agencies, that affect the consolidated financial statements of the Province, must be carried out in accordance with Canadian Public Sector Accounting Standards.

- 2. The Office of the Controller for the Province of Ontario should provide copies of all terms of reference to the Auditor General's Office when they engage private sector firms for accounting advice or opinions.

A response to the recommendations is due from Treasury Board Secretariat (TBS) to the Committee by August 30, 2018.

- April 25, 2018 – The Auditor General of Ontario released the Review of the 2018 Pre-Election Report on Ontario's Finances, and noted in that Review that the Province's accounting for the Fair Hydro Plan and net pension assets from jointly-sponsored pension plans were not reported correctly and was resulting in an understatement of the projected deficit for 2018-19 of $5.0 billion.
- February 28, 2018 – TBS, alongside the Secretary of the Cabinet, Ministry of Finance, Ontario Financing Authority, Ministry of Energy, Independent Electricity System Operator, and Ontario Power Generation, appeared before SCOPA for the Committee's review of Chapter 2 – Public Accounts of the Province, of the Auditor General's 2017 Annual Report.

BACKGROUND:

- The Public Accounts of Ontario is a key accountability and transparency document in the government's financial cycle. It's a look back that compares Ontario's actual performance to what was planned in the Budget.
- The Public Accounts present the consolidated financial statements of the Province, provide financial highlights of the past fiscal year, and report on performance in priority areas.
- The consolidated financial statements are audited by the Auditor General.
- The consolidated financial statements and the Auditor General's opinion thereon, is released as part of Public Accounts, generally in September of each year (due 180 days after March 31 year-end)
- When preparing the 2016-17 Public Accounts, Ontario's professional accounting staff adopted accounting changes.
- These changes include:
    - **Accounting for hospitals, school boards and colleges** - third-party revenues (i.e. tuition fees, patient fees, research grants and donations) are now reported together with provincial revenue. This change increases transparency and is supported by the Auditor General.
    - **Accounting for energy sector government business enterprises** - the financial results of investments in Hydro One and Ontario Power Generation (OPG) are reported using International Financial Reporting Standards. Previously, these results were reported using U.S. Generally Accepted Accounting Principles. This change was made to meet Public Sector Accounting Board standards and is supported by the Auditor General.
    - **Accounting for the Independent Electricity System Operator (IESO)** - the IESO has adopted rate-regulated accounting, and is now recognizing its market accounts assets and liabilities in its financial results.
    - **Accounting for net pension assets of jointly sponsored pension plans** - the Province is reporting net pension assets for jointly sponsored pension plans. This is in line with Public Sector Accounting Board standards and the recommendations of the independent Pension Asset Expert Advisory Panel.

Pension Asset Expert Advisory Panel

- On November 10, 2016 Ontario established the Pension Asset Expert Advisory Panel to provide independent advice and recommendations to the government on the application of public sector accounting standards to Ontario's net pension assets.
- The Panel was comprised of accounting, legal and pension experts in the areas of jointly sponsored pension plans, actuarial modelling for pension plans and Public Sector Accounting Standards.
- The Panel members were:
    - Tricia O'Malley; (Chair)
    - Murray Gold;
    - Uros Karadzic; and,
    - Paul Martin.
- Panel members also provided advice on how to value net pension assets reported on the province's books, taking into account future decisions which might be made by the plan's sponsor or sponsors.
- The Panel issued its report in February 2017. Upon receiving the report, the government, supported by its own research and analysis, accepted the Panel's recommendation and has reported the pension assets of the Ontario Teachers' Pension Plan (OTPP) and Ontario Public Service Employees' Union Pension Plan (OPSEUPP) in its 2016-17 consolidated financial statements (with restatement of 2015-16).
- The Panel issued a supplementary report in March 2017 with respect to the Healthcare of Ontario Pension Plan (HOOPP) and Colleges of Applied Arts and Technology Pension Plan (CAATPP) recommending that a full valuation allowance be recorded on the net assets of both of these plans, based on the difference in governance structure between these plans and OTPP and OPSEUPP. The province agreed and has recorded a valuation allowance for CAATPP in the year (amount is not material). The HOOPP plan was not in a net asset position for accounting purposes at March 31, 2017.

Independent Electricity System Operator

- The Independent Electricity System Operator (IESO) is a not-for-profit, non-taxable corporation established pursuant to Part II of the *Electricity Act, 1998*. The Ontario Power Authority and the IESO merged on January 1, 2015.
- One of IESO's roles is to settle the market accounts, which are the 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).
- Rate regulated accounting is appropriate where the rates an entity is able to charge to its customers are set by another party (i.e. a regulator), provided specified criteria are met. Rate-regulated accounting permits the entity to defer costs that would otherwise be currently expensed to the period that the related revenue is charged to customers. Costs able to be deferred by the IESO include:
    - Unrecovered smart metering expenses; and,
    - Unrecovered pension and post-employment benefits related to PSAB transition.
- During 2016, IESO made two accounting changes (1) to recognize the market accounts in its financial statements – these amounts were not previously recognized in the IESO's financial statements, and (2) to apply rate-regulated accounting.
- The IESO received an unqualified audit opinion from KPMG (their external auditor) with respect to the financial statement presentation in their 2016 audited financial statements. IESO management, IESO's Audit Committee, IESO's Board of Directors, IESO's external auditor, and the Office of the Provincial Controller

support the recognition of the market accounts and the use of rate-regulated accounting by IESO.

Revenue Highlights

Against the Restated 2016 Budget:

- Revenues for 2016-17 came in at $140.7 billion, or $2.2 billion higher than forecast in the 2016 Budget. This was largely due to higher than projected taxation revenues, non-provincial source revenues from hospitals, school boards and colleges, and income from GBEs, partially offset by lower than projected Government of Canada transfers and other non-tax revenue.

Against the Restated Interim Estimates in the 2017 Budget:

- Revenues for 2016-17 came in at $140.7 billion, or $0.6 billion lower than the interim forecast in the 2017 Budget. This was largely due to lower than projected taxation revenues and Government of Canada transfers, partially offset by higher than projected income from GBEs.

Expense Highlights

Against the Restated 2016 Budget plan:

- Total expense in 2016-17 was $141.7 billion, or $0.1 billion lower than forecast in the 2016 Budget plan. Program spending was $130.0 billion, up by $0.6 billion from a planned spending of $129.4 billion and interest on debt was $11.7 billion, lower by $0.7 billion from planned interest cost of $12.4 billion. Program spending was higher by $0.6 billion largely due to higher than projected spending in the health, community and social services, justice sector and general government and other.

Against the Restated interim Estimates in the 2017 Budget:

- Total expense in 2016-17 was $141.7 billion or $1.1 billion lower than the interim forecast in the 2017 Budget. Program spending was $130.0 billion, $0.9 billion lower than the interim forecast of $130.9 billion in the 2017 Budget. Interest on debt was $11.7 billion, lower by $0.2 billion from planned interest cost of $11.9 billion. Program spending was lower by $0.9 billion largely due to lower than projected spending in the health and education sectors, and other programs.

Net Debt

- Net debt as of March 31, 2017, was $301.6 billion, which was $6.7 billion lower than forecast in the 2016 Budget. Net debt grew by $6.2 billion during the year, representing a $6.6 billion increase in liabilities that was partially offset by a $0.4 billion increase in financial assets.

Auditor General’s 2017 Annual Report: Chapter on Public Accounts

- On December 6, 2017, the Office of the Auditor General released their 2017 Annual Report.
- The Auditor General’s Annual Report, Chapter 2 – Public Accounts of the Province, makes 10 recommendations regarding the Public Accounts of the Province.
- The recommendations largely reflect opinions that have been expressed in previous reports, including the Auditor General’s audit opinion in the 2016-17 Public Accounts and the Special Report on the Fair Hydro Plan.

Prepared by: Bharat Patel, Office of the Provincial Controller Division
Reviewed by:

Approved by:	**Name:**	**Date Approved:**
ADM, Office of the Provincial Controller Division	Cindy Veinot	
Senior Issues & Media Advisor, Communications Branch	Alisha Tharani	
Manager, Issues Management, Correspondence and Media Relations	Kate Vrancart	
Assistant Director, TBS Communications Branch	Bryant Sullivan	
Director, Communications Branch	Sofie Di Muzio	

Appendix

Preparation and Tabling:

The Public Accounts for each fiscal year are prepared under the direction of the President of Treasury Board, as required by the *Financial Administration Act*.

The Public Accounts of Ontario consist of the Annual Report and three supplementary volumes. The Annual Report includes the province's audited consolidated financial statements and a financial statement discussion and analysis section. Supplementary information is contained in three volumes:

Volume 1: Ministry statements for expenses, assets, revenue, detailed debt and other supplementary schedules. It provides a comparison of appropriations with actual spending.

Volume 2: Financial statements of significant provincial corporations, boards, commissions that are part of the government's reporting entity, and other miscellaneous statements.

Volume 3: Detailed schedules of payments made by ministries to vendors and transfer payment recipients.

The *Financial Administration Act* requires the President of Treasury Board to submit the province's Annual Report and consolidated financial statements to the Lieutenant Governor in Council (LGIC) on or before 180 days after fiscal year-end.

The process for release of the Public Accounts is as follows:

- The Public Accounts are approved by the Lieutenant Governor in Council.
- The LGIC lays the Public Accounts before the Assembly, if the Assembly is in session, and the Public Accounts are then released on the same day.
- If the Assembly is not in session on the day of the release of the Public Accounts the LGIC is required to make the Public Accounts public and the Public Accounts are laid before the Assembly <u>on or before</u> the tenth day of the next session.