Ontario

BACKGROUNDER

Treasury Board Secretariat

Summary of Government Responses to the Auditor General's 2017 Annual Report Chapter on Public Accounts

December 6, 2017

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. In her report, the Auditor mentions a number of topics that aim to represent previous and ongoing conversations regarding the Public Accounts of the Province. The government's position on these differences of opinion has not changed. Below is a summary of responses upon which the government has based its position regarding the Auditor's recommendations in Chapter 2 – Public Accounts of the Province.

Accounting for Pension Assets

The government continues to move forward and present the province's finances fairly and accurately and in accordance with Canadian Public Sector Accounting Standards (PSAS).

Last year there was a disagreement among the province's professional accounting staff and the Auditor General's Office on the appropriate application of PSAS regarding pension accounting. As a result, the Pension Asset Expert Advisory Panel was established to deliver independent advice and recommendations on the issue. The independent panel members concluded the province's share of the net pension assets of both the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan should be recognized in Ontario's financial statements.

After significant deliberation, Ontario confirmed that the accounting for these plans prior to 2015-16 was appropriate. This conclusion is supported by:

- The conclusions reached by an independent Pension Asset Expert Advisory Panel (the 'Panel'), established by the government to provide advice on the interpretation of PSAS with respect to the reporting of net pension assets of these two joint defined benefit plans. The Panel, comprised of accredited accounting, actuarial and legal professionals with extensive background in pension accounting and plan governance, released its report in February 2017 which supported the government's position that a valuation is not required for these two plans under PSAS. Two key findings of the Panel were: 1) there is no requirement under PSAS that any formal agreement exist between the joint sponsors regarding the timing or amount of a reduction in contributions to record an asset, as the existing agreements in place between the parties support the recognition of an expected benefit, and 2) unilateral control is not required for asset recognition; joint control with each party having the ability to deny the actions of the other sponsor, provides evidence of shared control, supporting recognition of an asset.
- 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.

Commented [HS(1]: Note to Comms: these bullets must be included in their entirety as wording has been cleared by the firms.

The government continues to apply the accounting treatment of pension assets that the province has used consistently since 2001.

IESO Market Accounts

In 2016, the Independent Electricity System Operator (IESO) began recognizing its market accounts' assets (amounts due from power distributors) and liabilities (amounts due to power producers) in its financial results. IESO chose to recognize these markets accounts on its books for transparency reasons, as it better reflects the financial position of the IESO-administered markets at year-end.

This change was supported by the IESO's Audit Committee, its Board of Directors, its independent external auditor, and by the Office of the Provincial Controller. It has no impact to the province's annual deficit, net debt or accumulated deficit.

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.

The accounting concepts used are consistent with those 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.

IESO Rate Regulated Accounting

PSAS is silent on the issue of rate-regulated accounting – the standards 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 section PS1150.07 from the Public Sector Accounting Standards Handbook.

In this case, the Independent Electricity System Operator (IESO) consulted U.S. Generally Accepted Accounting Principles (GAAP), the appropriate accounting framework that provides guidance on rate-regulated operations.

The IESO made the decision to adopt rate-regulated accounting because it better 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 all support the use of rate-regulated accounting by IESO.

Many entities in Canada, including Ontario Power Generation (OPG) and Hydro One use rate-regulated accounting. Rate-regulated accounting is well understood in the electricity sector, and the approach selected was taken in that context. The recognition of regulatory assets brings IESO in line with six other independent system operators in North America.

Ontario Fair Hydro Plan Accounting

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 proposed accounting for the OFHP reflects the economic substance of the transaction by differentiating costs borne by taxpayers versus those borne by ratepayers.

PSAS is silent on a key accounting issue regarding the OFHP – the standards 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 section PS1150.07 from the Public Sector Accounting Handbook.

The professional staff has appropriately applied this guidance in assessing the accounting for the OFHP.

The province, as always, will prepare its consolidated financial statements in accordance with PSAS, including the transactions resulting from OFHP.

Legislated Accounting

The province is committed to providing high-quality financial reports that support transparency and accountability in reporting to the public, the legislature, and other users.

For the 2015-16 Public Accounts, the government passed a time-limited regulation prescribing the accounting treatment for net pension assets in order to allow Treasury Board Secretariat and the Ministry of Finance officials to sign off on Public Accounts consistent with the fiscal impact of the Auditor General's interpretation of Public Sector Accounting Standards (PSAS). This regulation is the **only** example of where the accounting treatment was legislated, and the legislation did not align with the requirements of PSAS.

The *Ontario Fair Hydro Plan Act, 2017* and its related regulations **do not** create accounting rules or legislate the accounting. It is important to distinguish legislating the accounting from legislating the right of the government to recover amounts from specified ratepayers in the future, which in the absence of legislation, would have been collected from specified ratepayers as the costs were incurred.

The province, as always, will prepare its consolidated financial statements in accordance with PSAS.

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