Draft for discussion purposes

Dear Ms. Lysyk:

Re: Finalizing 2015-16 Public Accounts and Accounting for Jointly Sponsored Pension Plans

We would like thank you for the meeting of September 15, 2016 with you and your staff, where we were able to finalize the audit work on the Public Accounts, save for the issue we will discuss below. We appreciate the work that you and your staff have done as part of this year's audit, and we value the effective working relationships between the Office of the Auditor General and staff in our two ministries.

We also appreciate receiving your letter of September 13, 2016 on accounting for the accrued benefit assets for the Ontario Teachers' Pension Plan ("OTPP") and Ontario Public Service Employees' Pension Plan ("OPSEUPP") in the Province's financial reports.

We also thank you for taking time to meet with us and our advisors on September 14, 2016 to help us better understand the areas of concern noted in your letter, as well as for our subsequent discussions over the phone. Given the significant fiscal impact of pension plan accounting to the Province's reported financial position and results, and the inherent complexity of this particular area, we believe it to be in the public's and our mutual best interests to ensure that the accounting treatment is appropriate to achieve fair presentation of the Province's results.

It is unfortunate that we have not been able to agree upon the interpretation of the application of PS 3250 to the accounting for the accrued benefit assets related to the OTPP and OPSEUPP in the Province's financial reports. As you are aware, the Province has applied consistent accounting treatment for these plans for the past 15 years and has consistently received unqualified audit opinions, without exception.

Based on our respective positions at this time, and taking the above into account, we believe that this particularly complex accounting matter would benefit from additional discussions, information and consideration.

As noted above, the Province has been applying the requirements of PS 3250 to the treatment of its accrued benefit assets on a consistent basis for the past 15 years, since the date of adoption of the above standard in 2001. During that time, two successive Ontario governments have applied the same interpretation of PSAB. Under this consistent accounting treatment, OTTP and OPSEUPP have been reported on the Province's books as being in an asset position since the year ended March 31, 2002.

We understand that the decision to review the application of the pension asset ceiling test was not initially contemplated in your draft audit plan, dated February 24, 2016 for the 2015-16 Public Accounts audit, and that your office first raised your intent to look at this issue with staff in the Provincial Controller's office in June 2016. We were surprised by this somewhat late change in plans for your current audit of the Public Accounts, and more so with your September 13, 2016 correspondence that recommended a change in the accounting treatment that the Province has been using since 2001, suggesting all of the parties involved in the preparation of the financial statements and the audit thereof were incorrect in their interpretation of the accounting standards for the last 15 years. The current accounting treatment had been accepted by yourself for the years ended March 31, 2015 and March 31, 2014 and by two previous Auditors General, all of whom issued unqualified audit opinions with regards to the Province's financial statements.

With respect to the specific technical issues identified in your letter, it is not our interpretation that the standard requires that the Province must have a unilateral legal right to use the asset or that agreements between the parties be in place at year end in order to recognize the Province's share in the asset.

While you have repeatedly raised with us in our conversations since your September 13, 2016 letter the possibility of negotiating a phased-in approach to reporting the impact of the accounting changes you suggest, including in ways that would have no impact on the annual deficit for at least two years, we are not prepared to do so as it would be inconsistent with our understanding of PSAB accounting standards and requirements for reflecting changes. In any event, our position would not support changing the Province's reporting from what it has been over the last 15 years.

Commented [CV1]: I think we want to be specific here as some changes can be recorded to accumulated surplus. My suggestion "requirements for reflecting this type of change that in your letter of September 13, 2016, you have characterized as an error." She didn't use the word error, but did refer to required disclosure in PSAS that is only required for an accounting error

Beyond our differing views on the interpretation of the application of PS 3250, we remain concerned that the accounting treatment you propose would also make it more difficult for users to understand the Province's underlying financial position. For example, your accounting treatment would result in a $10.6 billion increase in the Province's accumulated deficit and net debt, without any increase to the Province's financing requirements as a result of higher reported net debt, since this would be a non-cash accounting adjustment.

You have looked at the Province's debt burden in your last two Annual Reports and have stated in your 2015 Annual Report that "ultimately, decisions about how much debt the province should carry, and the strategies to pay down that debt, are questions of government policy."It would, in our view, be an unfortunate outcome if the level of debt would be materially higher in 2015-16 as a result of accounting policy.

Commented [OG2]: NEED THIS FACT-CHECKED, ESP re TREATMENT OF NET DEBT AND FINANCING REQUIREMENTS

We have agreed to assemble related evidence that we believe supports the position of the Province and to provide that to you as soon as possible for your review and consideration as to whether the analysis of the Province's accounting treatment under PSAB is reasonable. The appendix to this letter includes a list of documents that we have made available to you in this regard.

Subject to your review of the evidence presented to you, we have considered our options with respect to concluding this year's Public Accounts process and view them to be the following:

1. Status Quo Interpretation

After reviewing and considering the evidence presented to you in its totality, including the external accounting opinion from Deloitte, you may be satisfied that the accounting treatment followed by the Province remains acceptable. In that case, we would expect that you would issue an unqualified opinion on the Province's financial statements, consistent with the last 15 years.

Commented [CV3]: Accounting opinions (and audit opinions) issued by the firms are signed Deloitte -- not by an individual partner. I suspect Kerry's name and title (National Director of Accounting Services) will be referenced as the main contact number in the letter and we will confirm that.

2. Jointly Seek External Review to Confirm Interpretation

In our telephone conversation on the afternoon of September 15, 2016 you had suggested that you would be willing to have the conclusions of the Deloitte opinion be jointly reviewed by a panel of the national accounting practice leaders of PwC, KPMG and EY. If the panel were to agree with the Province's interpretation as supported by Deloitte, you would then issue an unqualified opinion on the Province's financial statements.

Based on the review of the information provided to you, if you still feel that the issue at hand would benefit from an external panel's view, we would be prepared to jointly approach Deloitte and the three other firms with you to seek their participation on a panel. It is conceivable that not all firms noted above would participate for their own reasons that they may or may not justify, in which case we would be prepared to consider adding to the panel senior representatives of one or more of the other major accounting firms active in Canada, subject to our joint agreement. We have also notified you that PwC is also looking at this issue for the Province and thus they may decide that they are conflicted from participating in the panel. We are prepared to share with you any advice that PwC provides to the Province.

Such a panel would be a novel approach and unprecedented in the recent memory of preparing the Province's Public Accounts. However, given the complexity and significance of this issue, we would be prepared to take this extraordinary measure. We recognize that this would delay the tabling of Public Accounts as the panel would need to opine prior to you issuing an audit opinion.

3. Do Not Accept Status Quo Interpretation

Based on the professional advice and evidence received by the Province that the existing accounting treatment remains a reasonable way to present the Province's results and is in accordance with PSAB, management can only sign off on the Letter of Management Representation based on the Province's interpretation of PSAB. Therefore, we would present the consolidated financial statements reflecting the value of the pension assets for OTPP and OPSEUPP as calculated by the Province based on the Province's interpretation of PSAB. You have provided a draft of a qualified opinion that you would issue under this option.

[NTD: other options to potentially consider:

4. *Legislate accounting treatment to reflect AG's interpretation – remove this option if Oslers opinion re the AG's obligations to report under FAA and AG Act suggest that this is not viable, i.e., if the AG may refuse to provide an audit opinion*

   The Province could legislate the accounting for jointly sponsored pension plans to require that any pension asset resulting from the application of PS 3250 be written down to the value which you believe reflects an appropriate interpretation of the application of PSAB (i.e. NIL). Legislating this accounting requirement would permit the Province to produce financial statements in accordance with your interpretation of PS 3250 while recognizing that we remain unconvinced at this time that our interpretation is unreasonable. This alternative is the only way that our management could sign off on the Management Letter of Representation in which we would provide attestation to you that the Province's consolidated financial statements are prepared in accordance with legislation and PSAB.

   We believe that this alternative is the only means by which we would be able to sign off on the Management Letter of Representation at this time. [Add language re Oslers conclusions re. FAA and AG Act if they are favourable to the Province] This would also not preclude continuing to work with you and other experts in the future with an objective of reaching consensus on the appropriate interpretation of PSAB, which the Province would be committed to do as part of an ongoing dialogue in which we hope you would participate.

5. *Adjust the Province's position on accounting treatment based on outcome of Deloitte opinion – remove this option if Deloitte finds that Province's accounting treatment is reasonable]*

We acknowledge the important work that your Office does in auditing the Province's Public Accounts, and the value of your independent audit opinion to support the presentation of the Province's reported results to the Legislature, the public and other users. We are optimistic that we can work together to resolve this item in a way which best serves the public interest.

Scott Thompson Greg Orencsak
[add titles]

c. Cindy Veinot
Nadine Petsche

[Add Appendix listing documents and one-line summary of their content/relevance]