AUDITOR GENERAL – STANDING COMMITTEE ON PUBLIC ACCOUNTS (EXCERPT)

Date:	March 21, 2018
Length:	14 minutes
Speaker(s):	Bonnie Lysyk, Auditor General

BONNIE LYSYK, AUDITOR GENERAL: And the other one...and the other document that I wanted to be aware of, it's a...we had, within our Chapter 2, so it was the report that you had people hearing...held the hearing on at the end of February. In that chapter, recommendation five dealt with IESO and IESO modifying their accounting to remove market accounts and rate-regulated accounting from their statements. And as a result of lack of communication by their external auditors with us last year, and other concerns we had, we initiated a special financial statement audited IESO. So we actually went into IESO. David is...was the manager on that file. And we did our own review of the finances at IESO. And this, this document is for your consideration in your deliberations around your report on the public accounts, chapter two.

I think a key thing that I wanted to highlight is there's a few key things. The reason why we do this is because under our legislation the what we call component auditors, which in this case is KPMG, are accountable to us in terms of ensuring that we have no surprises. They are accountable to us in the terms in the sense that we review their working papers and we can ask questions. Because they are a component auditor to the consolidation in the public accounts, we need good, clean, open communication and the ability to work with them. Well, unfortunately, there's a different dynamic happening here, in the sense that KPMG provided advisory services on the Fair Hydro Plan, but they also are the external auditors for IESO. And that caused us some concerns because of the last minute changes to IESO statements last year. So when we finished our work, we have confirmed that the changes that were made to the IESO statements were directly related to the Fair Hydro Plan, so we comment on that and here. We also comment that during our work, management, IESO, and the board would not cooperate with us during this work, in the sense that they continually say they're cooperating, but they stalled on giving us information. They wouldn't sign the management representation confirming that they gave us all the information. They wouldn't also agree that that what their roles and responsibilities are with respect to this audit. And they basically treated I think my audit team like we were subservient to KPMG, which, in terms of the law in Ontario, that would be the reverse. Having said all that, we managed through it. Because we couldn't get the documentation we needed under Canadian auditing standards for us to sign...for me to sign an opinion, we have an independent auditor's report, but we have to do what we call a disclaimer of opinion, meaning because management didn't sign this material, I can't opine. But what I can tell you in this, in this document, and it's in attachment one, is that what the impact of the errors in the IESO statements will be on the public accounts of Ontario. And so on page...attachment 1, page 3, we indicate that up until December 31st, the annual deficit would be understated by $1.3 billion. And there's other information here. We also note that on their pension unfunded retirement benefit plans, for the last number of years they've understated their pension liability on their financial...their benefit liability on their financial statements. So we well...we are awaiting a number from the actuary on that. To their statements, it will be material. To the provinces statements, it will be a reportable item over what we call a material amount. It won't impact the bottom line, but it is significant.

And the third thing that we came across, which we found interesting, which was given to us in a box of papers after we were basically finished the audit and not given to us online, like most of the other documents, is documentation around the fact that the assets of IESO have been pledged as collateral and security against the Fair Hydro Trust, for the Fair Hydro Trust. So in order to borrow money at the Fair Hydro Trust, the assets of IESO were pledged. And what that means is that...and it was with respect to the carrying costs. So what it means though is that the generators fall behind the creditors for the IESO trust, the Fair Hydro Plan Trust. So we asked management and the board to disclose this in their financial statements and they have not. And I think we're still wondering why they won't, other than the fact we know that they thought it was a risk that the generators would not like this. So Bruce Power would be concerned that IESO pledged as collateral the incoming revenues they would receive from the LDCs. So the generators fall behind the creditors at the bank now, basically, in receiving their money. So that is an item that we have brought up with them and we're concerned that it's not (inaudible) disclosed. KPMG, at this point, we, we understand they've issued a clean opinion, contrary to ours. They've issued a clean opinion and the statements that don't disclose what we think is the correct Retirement Benefit Plan amount, that don't disclose the collateral security agreement pledging, and that use market accounts and rate regulated asset treatment on their statements. So they have...we don't have for you the IESO statements because the opinion of KPMG and the statements haven't been made public yet. When we get the statements we will give you the statements because in our independent auditor's report, we refer to certain notes that talk about the accounting and you'll see that when you read this document. I think the other thing I just wanted to mention too, in terms of an update, that IESO normally has an audit fee of $86,500 a year on their audit. For the year January to December 2017, KPMG is billed nearly $600,000 to the organization. Part of that money is for advisory services on writing papers for IESO to defend their position on this accounting. And part of it is, they say, for communication with us. So they say that we cost $230,000 to answer our questions. So it's ridiculous. We think it's ridiculous. But anyway just on this aspect of the Fair Hydro Plan, KPMG has generated about half a million dollars. And we think this accounting is bogus. And we think we're trying to argue a position because of the way that they've embedded themselves in the whole transaction.

So we will pursue this further we're still working, I mean, we're open to IESO coming and saying they're going to correct their statements. When it comes to the provincial statements we're going to be requesting again the province Controller's office to reverse the impact of IESO on the government statements. The reason why this entity is so important to the government's statements is from an accounting perspective we take all the information IESO. And every number is supposed to be reflected in the government's statements but because it's wrong in IESO then that's why we have to say to the province we need you to correct this. And what we're telling in this report is that at this point we know it's at least over a billion dollar adjustment from this accounting.
I'm just wondering if there's anything else that I haven't mentioned Susan. Anything else?

UNIDENTIFIED: I think you've covered it.

LYSYK: Covered it? So this information then is for you to cogitate in drafting your report. If there's anything you think you want to comment on with respect to this. If you have any questions on this feel free to ask. We're more than prepared to address all of these points. I just want to say that it is in my career. It's very unusual to have experienced management team and a board basically treating our office like they did. But we got through it and we'll work through them and we'll continue to work through them. But I think it, I think David would say it was probably one of the hardest audits in his career. So yeah, yeah. So we also have attached here a management letter. So what that is, is it says when you have an external audit done by your organisation and the external auditors look at your organisation and they see that there's areas for improvement, you give you give a management letter. Now we give this to all our clients if we have issues. In terms of this management letter I want to highlight a couple of things. I want to highlight that one item attachment to is bank reconciliations. Pretty much when you're auditing the bank for an entity you make sure that an organisation is doing bank reconciliations and that they're done. I can tell you that my team was the team that said can I see your bank reconciliations and they couldn't provide any to us. So then they had to reconstruct the bank reconciliations for us. But this doesn't indicate...

RANDY HILLIER, MPP: That's real basic...

LYSYK: You got it.

MPP HILLIER: Like that is at the essence here.

LYSYK: You got it. So then my team had to reconstruct it okay. It was never pointed out by their previous auditors and you'll see that in their response here they say that they are preparing them on a regular basis. Well they never did. So this is what we've been dealing with. A situation where there's a lot of non-truths that are being provided to us during the course of the audit. So that is a simple example of something. The other one is the pensions. In every entity within Ontario's public sector that we were able to find statements on that consolidate into the government that have benefit liabilities, those benefit liabilities use a certain discount rate. So if there are planned assets they use that. If they don't have any assets they use a borrowing rate. My audit team found out that they were using a plan asset rate for their liabilities that don't have any plan assets against those liabilities. So we pointed that out. Unfortunately IESO has not adjusted their statements for it yet. We pointed out to their auditors and said we think this is going to be material and they basically signed off without responding to us other than saying we think it can be done both ways. The only problem is we can't find a set of statements in the public sector in Ontario that's done both ways and we polled KPMG's other clients and they're doing it exactly the same way we've pointed out to them. So this is the kind of thing that we've been dealing with.

LIZ SANDALS, MPP: On the pension this is a different issue than on TPP. It isn't about the joint management of the plan. This is just strictly about the discount rate.

LYSYK: That's correct. That's correct. So this doc and the other one is, we found security deposits you know. Normally you reconcile security deposits so that you know how much money to give back. These are these are security deposits on, I forgot what these are on David.

(inaudible)

Right. Right. Right. So if you don't need the money any more you pay back the security deposit. So we found, and for their statements it's material. For the province it's not. We found one point, over a million dollars that they couldn't figure out who they owed the money to. And they were never doing these reconciliations. So these are some basic things that just going in one year we found. We asked at the beginning of this exercise to either have us do your audit without KPMG, have us do a joint audit with KPMG so it forces the two audit firms us and them to sit at the table and go through all these issues. But they chose the board management chose no. You know we'll keep KPMG, you come and do whatever you want. So that does put us in a more difficult position. They have said to us that they'll consider appointing us their auditor next year. I would recommend they do that. Because I think they've got some issues that we need to still work with them on. But, but having said that, I think the objective of us doing it this year was to ensure we meet our mandate under our legislation to make sure that the component auditor was basically disclosing everything and handling the audit as we would think would be appropriate.