Chapter 2

Public Accounts of the Province

Introduction

Ontario's Public Accounts for each fiscal year ending on March 31 are prepared under the direction of the Minister of Finance, as required by the *Ministry of Treasury and Economics Act* (Act). The Public Accounts comprise the province's annual report, including the province's consolidated financial statements, and three supplementary volumes of additional financial information.

Preparing the consolidated financial statements is the Ontario government's responsibility. This responsibility encompasses ensuring that the information, including the many amounts based on estimates and judgment, is presented fairly. The government is also responsible for ensuring that a system of control, with supporting procedures, is in place to provide assurance that transactions are authorized, assets are safeguarded, and proper records are maintained.

My Office audits these consolidated financial statements. The objective of our audit is to obtain reasonable assurance that the statements are free of material misstatement—that is, that they are free of significant errors or omissions. The consolidated financial statements, along with my Auditor's Report on them, are included in the province's annual report.

The province's 2008/09 annual report also contains a Financial Statement Discussion and Analysis section that provides additional information regarding the province's financial condition and fiscal results for the year ending on March 31, 2009, including some details of what the government accomplished in the 2008/09 fiscal year. Providing such information enhances the fiscal accountability of the government to both the Legislative Assembly and the public.

The three supplementary volumes of the Public Accounts consist of the following:

- Volume 1—statements from all ministries and a number of schedules providing details of the province's revenues and expenses, its debts and other liabilities, its loans and investments, and other financial information.
- Volume 2—audited financial statements of significant provincial corporations, boards, and commissions whose activities are included in the province's consolidated financial statements, as well as other miscellaneous financial statements.
- Volume 3—detailed schedules of ministry payments to vendors and transfer-payment recipients.

My Office reviews the information in the province's annual report and in Volumes 1 and 2 of the Public Accounts for consistency with the information presented in the province's consolidated financial statements.

The Act requires that, except in extraordinary circumstances, the government deliver its annual report to the Lieutenant Governor in Council on or before the 180th day after the end of the fiscal year. The three supplementary volumes must be submitted to the Lieutenant Governor in Council before the 240th day after the end of the fiscal year. Upon receiving these documents, the Lieutenant Governor in Council must lay them before the Legislative Assembly or, if it is not in session, make the information public and then, when the Legislative Assembly resumes sitting, lay it before the Legislative Assembly on or before the 10th day of that session.

This year, the government released the province's 2008/09 Annual Report and Consolidated Financial Statements, along with the three Public Accounts supplementary volumes, on September 25, 2009, meeting the 180-day deadline.

The Province's 2008/09 Consolidated Financial Statements

The *Auditor General Act* requires that I report annually on the results of my examination of the province's consolidated financial statements. I am pleased to report that my Auditor's Report to the Legislative Assembly on the province's consolidated financial statements for the year ended on March 31, 2009 is clear of any qualifications or reservations and reads as follows:

> To the Legislative Assembly of the Province of Ontario
>
> I have audited the consolidated statement of financial position of the Province of Ontario as at March 31, 2009 and the consolidated statements of operations, change in net debt, change in accumulated deficit, and cash flow for the year then ended. These financial statements are the responsibility of the Government of Ontario. My responsibility is to express an opinion on these financial statements based on my audit.
>
> I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes assessing the accounting principles used and significant estimates made by the Government, as well as evaluating the overall financial statement presentation.
>
> In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 2009 and the results of its operations, the change in its net debt, the change in its accumulated deficit, and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.
>
> [signed]
>
> Toronto, Ontario
July 31, 2009
>
> Jim McCarter, FCA
Auditor General
Licensed Public Accountant

Deficits and Debt

EFFECT OF THE GLOBAL ECONOMIC DOWNTURN ON THE PROVINCE'S FINANCES

The global economic downturn over the past year has severely impacted the province's economy, causing tax revenues, especially from corporate taxes, to fall significantly. This was the main reason the province reported a deficit of $6.4 billion in its March 31, 2009 consolidated financial statements. The province's total debt, which includes all provincial borrowing, has risen to $176.9 billion from

$162.2 billion a year earlier. At the same time, Ontario's net debt, which measures the extent to which the province's total liabilities exceed its financial assets, is $153.3 billion, up from $142.4 billion a year earlier. Debt has increased more than this year's deficit primarily because of the province's investments in capital assets.

In its 2009 Budget, the government projected a deficit of $14.1 billion by the end of 2009/10, $12.2 billion for 2010/11, and $9.7 billion for 2011/12. The government said reduced revenues due to the global economic downturn and planned increases in government spending on provincial infrastructure and skills training over the next few years are primarily responsible for the projected deficits. Since the release of the 2009 Budget, Ontario, like other jurisdictions such as the federal government, has had to update its financial projections. The Ministry of Finance (Ministry) in its Ontario Finances, First Quarter Update of June 30, 2009, increased the 2009/10 fiscal-year deficit projection to $18.5 billion from the $14.1 billion in the March budget. The Ministry attributed this higher deficit projection to a weaker-than-expected economy and higher expenses arising from its support of the automotive sector. In its 2009 Ontario Economic Outlook and Fiscal Review, released on October 22, 2009, the Ministry further increased its deficit projections to $24.7 billion for 2009/10, $21.1 billion for 2010/11, and $19.4 billion for 2011/12. The Ministry attributes these higher deficits to further reductions in projected revenues due to a weaker economy than was previously anticipated and further increases in government spending.

Figure 1 presents a summary of Ontario's annual deficits and surpluses since the 1993/94 fiscal year when the province reported an $11.2 billion deficit, the highest ever recorded.

The annual deficits and infrastructure spending that the government is projecting over the next few years will substantially increase the province's debt. Although in its 2009 Budget the government projected its net debt would increase to $169.8 billion by the end of the 2009/10 fiscal year, the October 2009 Fiscal Review raised that projection to $184.1 billion, a 20% increase over the $153.3 billion as of March 31, 2009.

MINISTRY RESPONSE

Like many governments around the world, Ontario continues to face significant economic challenges, and the government will need to establish a plan to return the province to a sustainable and firmer fiscal footing. In order to create jobs, help families, and position the province for future growth, the government has chosen to invest in infrastructure, in skills training, and in reshaping the tax system. As announced in the 2009 Ontario Economic Outlook and Fiscal Review, the government is taking additional steps to ensure the sustainability of our public services. These initiatives will support the continued relevance and effectiveness of government programs over the longer term. An update to the government's plan to eliminate the deficit will be presented in the 2010 Budget.

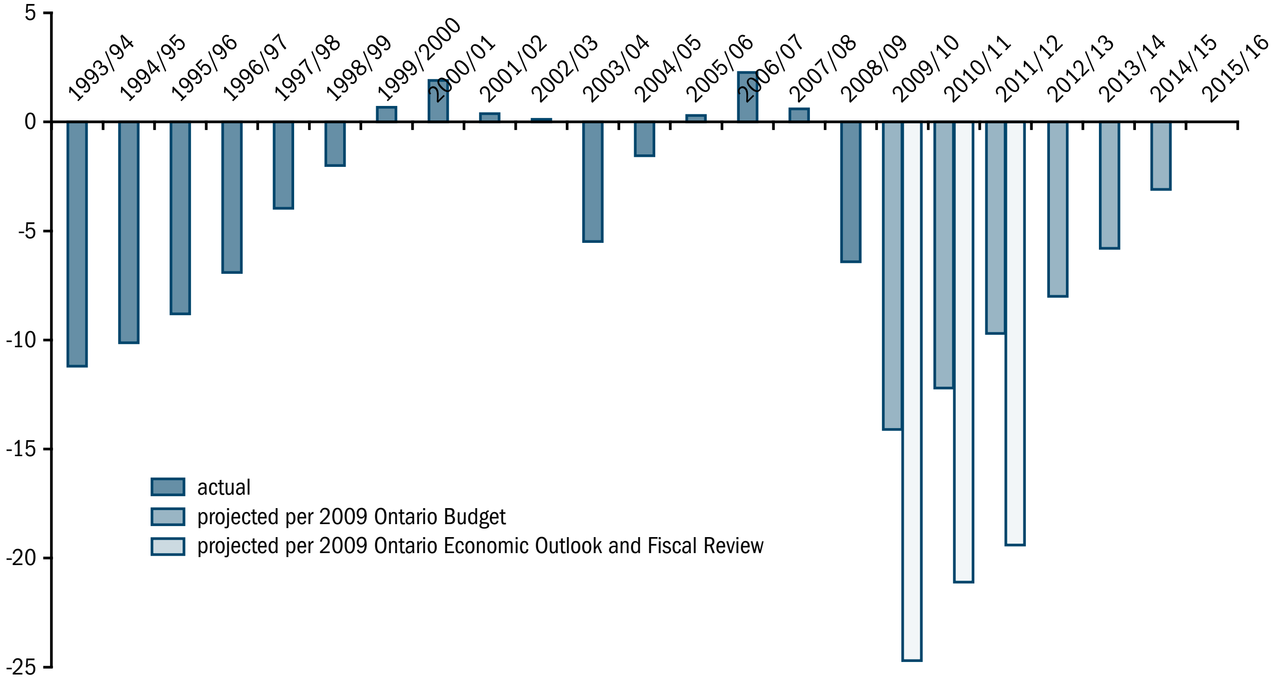
THE PROVINCE OF ONTARIO BORROWING PLAN

The government must borrow in order to finance its deficits. It must also borrow to replace maturing debt and fund its investments in built or acquired capital assets. The borrowing outlook presented in the 2009 Ontario Budget projected that the government will need to borrow $34.8 billion in the 2009/10 fiscal year. This projection was increased to $42.6 billion in the October 2009 Fiscal Review.

The 2009/10 borrowing program reflected in the October 2009 Fiscal Review is significantly larger than last year's $28.7 billion in borrowing and more than twice as large as in 2007/08. The 2009/10 projected borrowing reflects the large deficits and planned increases in infrastructure spending over the next few years.

Figure 1: Provincial Surpluses/Deficits, 1993/94–2015/16 ($ billion)

Sources of data: *Province of Ontario Consolidated Financial Statements*, *2009 Ontario Budget*, and *2009 Ontario Economic Outlook and Fiscal Review*



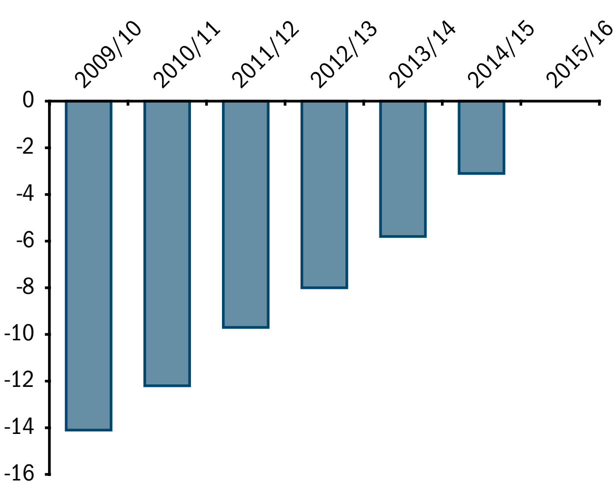
ONTARIO'S PLAN TO ELIMINATE THE DEFICIT

The *Fiscal Transparency and Accountability Act, 2004* requires the government, when it projects a deficit, to outline its plan to balance the budget. In the 2009 Ontario Budget, the government set out its plan to eliminate the deficit by the 2015/16 fiscal year. Figure 2 provides a summary of the future deficits projected in this recovery plan.

The government plan was based on managing expenditures; specifically, by holding the average annual rate of growth in program expenses to less than the average annual growth in total revenue over the period of the recovery plan and by finding efficiencies to reduce the costs of running programs. However, given the size of the projected deficits reported in the October 2009 Fiscal Review of $24.7 billion, $21.1 billion, and $19.4 billion in 2009/10, 2010/11, and 2011/12, respectively, the government will need to prepare an updated plan to eliminate the deficit.

Figure 2: Provincial Deficit Elimination Plan, 2009/10–2015/16 ($ billion)

Source of data: *2009 Ontario Budget*



FINANCIAL CONDITION INDICATORS

In 1997, the Canadian Institute of Chartered Accountants (CICA) published a research report, *Indicators of Government Financial Condition*, which suggested that a core set of indicators, common to all governments and presented on a consistent basis over time, would reduce the subjectivity of determining whether a government's financial condition is improving or deteriorating.

In September 2008, the CICA's Public Sector Accounting Board (PSAB) issued a draft statement of recommended practices. In March 2009, PSAB approved this draft and expects to release it in final form to the public in the near future. The draft recommends that a government adopt a specific framework when reporting on indicators of its financial condition. It defines the government's financial condition as its "financial health as assessed by its ability to meet its existing obligations both in respect of its service commitment to the public and financial commitment to creditors, employees, and others."

PSAB also suggests that governments calculate many of their specific financial indicators from information contained in their consolidated financial statements, often in combination with public information about the economy. The province is currently reporting a number of these financial indicators in its Budget and Annual Report.

ONTARIO FINANCIAL CONDITION IN BRIEF

Ontario's overall financial condition, as determined by PSAB's recommended measures, will undoubtedly deteriorate over the next few years, based on the government's current projections. This is to be expected, given the recent slowdown in the provincial economy.

It is important to note that the question of what the budgeted surplus or deficit should be or how much debt the government should incur is a policy decision outside the mandate of my Office. Therefore, our analysis of the province's financial health is presented in order to demonstrate how this type of information can be useful to governments, legislators, and the public in assessing the province's deteriorating financial condition.

PSAB has recommended the use of several indicators to measure the sustainability, flexibility, and vulnerability of government finances. Below, we concentrate on those indicators we consider most significant to help explain the impact of the large looming deficits and debt increases on the province's financial condition.

Sustainability

Sustainability is the degree to which a government can maintain its existing financial obligations, both with respect to its service commitments to the public and financial commitments to creditors, employees, and others without increasing the debt or tax burden. Sustainability addresses the government's ability to manage its financial and program commitments and debt burden. The cost of servicing increased debt levels can also have an impact on government programs as interest costs consume a greater proportion of revenues. Two key sustainability indicators are as follows.

Net Debt as a Percentage of GDP

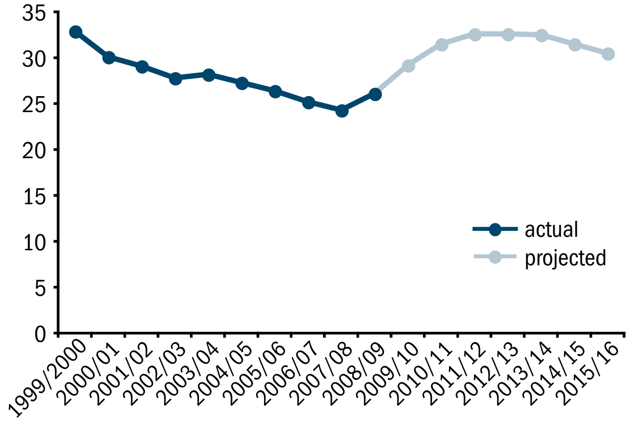
Net debt, or liabilities minus financial assets, is a particularly significant measure of a government's financial position as it reflects the future provincial revenues that will be required to dispose of its liabilities. Gross Domestic Product (GDP), the total value of all goods and services produced, is the critical measure of an economy's output or wealth, which, over time, correlates to future expected provincial revenues.

The net-debt-to-GDP ratio indicator measures the relationship between a government's obligations and its capacity to raise funds to meet them. When the ratio is rising, it means that the government's net debt is growing at a faster rate than the provincial economy.

The province's net-debt-to-GDP ratio is expected to increase over the next three years, reflecting the government's decision to significantly increase its borrowings in order to fund its deficits and infrastructure investments. However, as shown in Figure 3, the net-debt-to-GDP ratio has been

Figure 3: Ratio of Net Debt to Gross Domestic Product (GDP), 1999/2000–2015/16 (%)

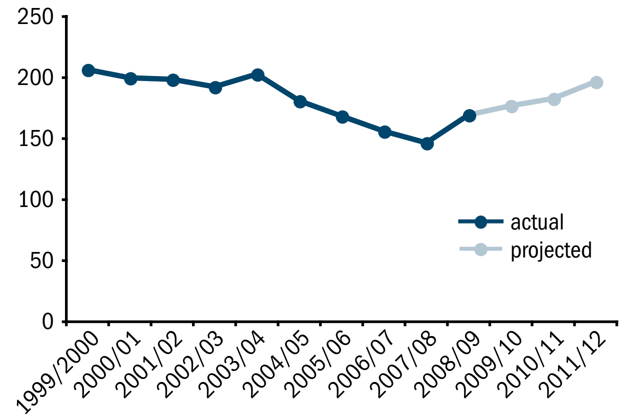
Source of data: *2009 Ontario Budget*



Note: Projections reflect amounts reported in the 2009 Ontario Budget but do not reflect the impact that the higher deficits reported in the 2009 Fiscal Review will have on this ratio because the information is not presented in the 2009 Fiscal Review.

Figure 4: Net Debt as Percentage of Total Annual Revenues, 1999/2000–2011/12

Source of data: *2009 Ontario Budget*



Note: Projections reflect amounts reported in the 2009 Ontario Budget but do not reflect the impact that the higher deficits reported in the 2009 Fiscal Review will have on this ratio because the information is not presented in the 2009 Fiscal Review.

falling steadily since the turn of the last decade. As reflected in the 2009 Ontario Budget, the ratio was projected to increase by more than one-third, from a low of 24.3% in the 2007/08 fiscal year to a high of 32.6% in 2011/12. However, given the revised deficit projections in the October 2009 Fiscal Review, the ratio is now expected to be higher and to increase to around 37% by 2011/12.

The province's March 31, 2009 annual report and consolidated financial statements use the ratio of the accumulated deficit to GDP as a key measure of Ontario's fiscal economic health, consistent with the definition of provincial debt outlined in the *Fiscal Transparency and Accountability Act, 2004*. The net-debt-to-GDP ratio is also a key indicator of government sustainability because it deals with the debt that must be repaid relative to the value of the output of Ontario's economy.

Ratio of Net Debt to Total Annual Revenues

The net-debt-to-total-annual-revenues ratio is an indicator of how much time would be needed to eliminate the province's debt if all revenues could be devoted to it. As shown in Figure 4, the ratio of Ontario net debt to total annual revenues was quite stable from the 1999/2000 fiscal year through 2003/04, averaging 200% over the period. From 2004/05 through 2007/08, there was a steady decline in the ratio to 147%, reflecting the fact that, while the province's net debt remained essentially the same, annual provincial revenues were increasing. Although this positive trend was encouraging, we note from the 2009 Ontario Budget that from 2008/09 onward, the ratio of net debt to total annual revenues was projected to increase each year and was expected to return to the 200% level by 2011/12. However, given the revised deficit projections in the October 2009 Fiscal Review, the ratio is now expected to be 238% by the end of the 2011/12 fiscal year.

Flexibility

Flexibility measures the degree to which a government can change its debt or tax burden to meet existing financial obligations. Current borrowings reduce the government's future ability to respond to adverse economic circumstances. Similarly, increasing taxes or government fees may reduce the government's ability to levy such measures in the future as the government approaches the limits that the public is willing and able to bear.

Again, we examine two indicators for this measurement.

Interest Expenses as a Percentage of Provincial Revenues

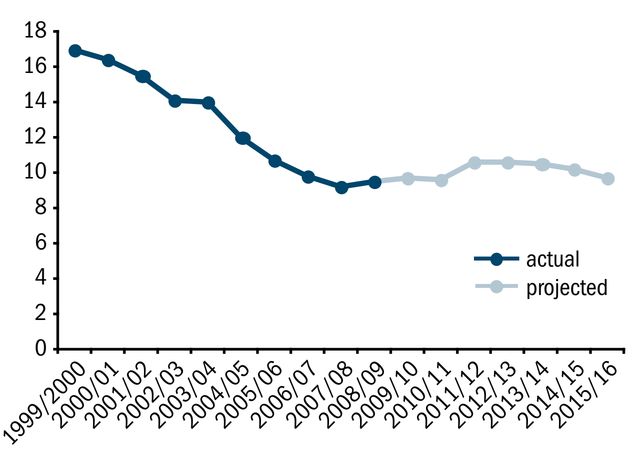
Increases in the cost of servicing total debt, or interest expenses, can directly affect the quantity and quality of programs and services that government can provide. The more government revenues that are needed to pay interest costs arising from past borrowing, the less will be available for program spending.

The interest-expense-to-revenue ratio illustrates the extent to which servicing past borrowing takes a greater or lesser share of total revenues.

As noted in Figure 5, the province's interest-expense-to-total-revenues ratio has been decreasing steadily over the past decade, even as provincial net debt has been increasing. In fact, even with the significant increases in net debt over the next few years, the projected ratio is still much lower than what it was in the early 2000s due to an increasing revenue trend and lower projected interest rates.

Figure 5: Interest Expense as Percentage of Total Revenues, 1999/2000–2011/12

Source of data: *2009 Ontario Budget*



Note: Projections reflect amounts reported in the 2009 Ontario Budget but do not reflect the impact that the higher deficits reported in the 2009 Fiscal Review will have on this ratio because the information is not presented in the 2009 Fiscal Review.

Based on the projected revenue and expense details provided in the 2009 Budget, and subsequently updated in the October 2009 Fiscal Review, the lower ratio is projected to continue through to the 2011/12 fiscal year, although it is projected to increase from the low in 2007/08. If this indicator increases for an extended period of time because of increased borrowing or higher interest rates, it will reduce the amount of flexibility the government has to spend money on programs providing public services.

Interest rates have been relatively low and falling over the past several years, recently approaching record low levels. This has enabled the government to keep interest expenses relatively consistent even as its total borrowing has been increasing.

The Risk Management and Derivative Financial Instruments note to the province's March 31, 2009, consolidated financial statements states: "Based on floating rate interest-bearing financial instruments at hand at the balance sheet date plus planned refinancing of maturing debt in the coming year, a one-percent-increase in interest rates would result in an increase in interest expenses of $230 million." In other words, if interest rates increase, even if debt levels remain constant, the government will pay more to carry this debt and thus have less flexibility to respond to future program needs.

Own-source Revenue as a Percentage of GDP

The ratio of own-source revenues, primarily tax and fee revenues, to GDP is important because it shows the extent to which a government is taking income out of the economy, either through taxation or user charges. If the indicator is increasing, it demonstrates that the government may have less room to raise taxes or increase fees. From the 2002/2003 fiscal year to projections for 2011/12, the government's own-source revenue as a percentage of GDP will likely hold steady, and, on the basis of projections in the 2009 Ontario Budget, we estimate that it will range between 11.7% and 13.0% and average 12.3%. The ratios are expected to remain in this range on the basis of the updated projections in the October 2009 Fiscal Review.

Vulnerability

Vulnerability refers to the degree to which a government becomes dependent on outside revenue sources or is exposed to risks that could impair its ability to meet existing obligations, both with respect to its service commitments to the public and its financial commitments to creditors, employees, and others. It is an important aspect of financial condition because it provides insight into a government's reliance on funding sources that are beyond its control and influence, such as revenue transfers from other levels of government. A government whose vulnerability is relatively low has greater control over its finances.

Ratio of Federal Government Transfers to Total Revenues

Although revenue projections have not been published beyond the 2011/12 fiscal year, the proportion of revenue that the Ontario government receives from the government of Canada has become more significant over time. Although 11.7% of the province's revenue came from the government of Canada in the 2001/02 fiscal year, this percentage has increased in each subsequent year and is projected to reach a high of 20.1% in 2009/10, falling back somewhat to 19.6% in 2011/12, as has been reported in the 2009 Ontario Budget. In reviewing the revised projection in the October 2009 Fiscal Review, we note that the proportion of revenue that the Ontario government receives from the federal government follows the same pattern as projected in the 2009 Ontario Budget, with the ratio standing at 21.2% in 2009/10, 23.1% in 2010/11, and 20.5% in 2011/12. This illustrates the dependence of the province on the government of Canada and that over the last decade the province's vulnerability to Ottawa's fiscal decisions has increased. The federal government is facing fiscal problems of its own, and any future reductions in federal transfers could result in the province having to issue more debt or raise taxes or fees if it wishes to maintain its spending plans.

THE CHALLENGES AHEAD

Our analysis indicates that the province's financial condition has generally been improving since the 2001/02 fiscal year. However, this trend will reverse over the next few years due to the large deficits and debt increases the government is projecting. Although the resulting financial indicators at the end of the 2011/12 fiscal year based on the 2009 Budget are not significantly out of line with the same indicators of a decade ago, the latest government projections indicate that further deterioration in the province's financial condition is anticipated.

Unspent Grants

BACKGROUND

Over the years I have expressed two concerns with respect to government year-end spending practices.

The first related to the government flowing hundreds of millions, and even billions, of dollars at year-end to fund activities of future periods while expensing such grants as current-year expenses in its consolidated financial statements. This accounting presentation could convey that monies had been spent providing programs and services during that fiscal year, while in reality, little or no services had been provided and little or no benefits had been received by the public. However, I have acknowledged that accounting for such transfers as expenses was acceptable under Public Sector Accounting Board standards.

My second concern focused on the weakening of normal accountability controls over transfers that occurred with these year-end grants, as the government, to meet accounting criteria allowing for their immediate expense recognition, often eliminated or significantly reduced the conditions under which such grants were provided to recipients. I was pleased to report last year that, after working with the Ministry, we were able to agree on a number of accountability and control provisions that could be included in these year-end transfers, addressing many of my concerns in this area.

EXPENDITURES AND 2007/08 FISCAL YEAR-END TRANSFERS

Year-end Grants

In last year's Annual Report, I also expressed concerns about the *Investing in Ontario Act, 2008* (Act, in this section). My primary concern was that, through this legislation, the government granted itself the power to determine how transactions would be accounted for in the province's consolidated financial statements. My objection was that generally accepted accounting standards, not government legislation, should determine how transactions are accounted for. I indicated that we would not support the use of legislative provisions to override generally accepted accounting standards.

In the 2007/08 fiscal year, the government provided an additional $1.1 billion in transfers to municipalities under the Act to fund infrastructure investments. The proposed transfers were announced and committed to by the government before March 31, 2008, and, therefore, were properly recorded as an expense in the 2007/08 fiscal year. The funds were actually transferred after the tabling of the 2007/08 Public Accounts in late August 2008.

Municipalities generally had the discretion to spend these funds on their own infrastructure priorities. The transfers were subject to a number of accountability provisions, including: the requirement to report by March 31 of each year, until the money was fully spent, how the funds were used; the right of the province to independently verify or audit the municipal expenditures; and the right of the province to recover the funds if they were not used as intended.

In addition to the $1.1 billion in transfers to municipalities under the Act, expenditures in the 2007/08 fiscal year included $1.9 billion in year-end grants provided to a number of other transfer payment recipients. These included grants of $400 million to communities outside of Toronto for roads and bridges, $200 million to universities to maintain and upgrade their facilities, and $100 million in transfers for social housing infrastructure. Accountability provisions similar to those included with the transfers made under the Act were also incorporated into these grant awards.

Unspent Grants

In its 2009 Budget, the government indicated that it planned to make significant investments over the next two years to stimulate the provincial economy. This included some $32.5 billion in spending on infrastructure projects. The government noted this stimulus spending must not only be significant in size but must be effective in restoring growth. The government noted that, to be effective, the grants should support quick-start projects. In other words, the fund should not sit for extended periods in the bank accounts of transfer-payment recipients.

Given the massive amount of stimulus spending that the government is planning to undertake over the next two years, the potential for some of these funds not to be spent cost-effectively is undoubtedly a program risk. As well, economists and other academics have recently expressed concerns that despite governments' stimulus spending commitments, many projects will be slow to start and that the actual investments may not be made for several years. In such cases, the "stimulus effects" will also not be felt for several years. As the following examples relating to last year's year-end investments indicate, these concerns may have some merit.

During our audit of the 2008/09 Public Accounts, we noted that much of the $1.1 billion in infrastructure money provided to municipalities under the Act remained unspent.

In accordance with PSAB standards, the amounts transferred to municipalities under the Act were recognized as a provincial expense for the 2007/08 fiscal year. We reviewed funding provided to 25 of the 445 municipalities, representing over 70% of the funds transferred under the Act, to determine the amounts that had been used as of March 31, 2009, approximately six months after the transfers flowed to the municipalities. Our observations included:

- Only two of 25 municipalities had fully spent 100% of their funding, totalling $22 million. In fact, 15 municipalities had not spent any of the nearly $330 million they had received.
- Seven municipalities had spent only a small portion of their grant monies: for example, one municipality spent only $141,000, or less than 0.2% of its $77.3 million; another spent only about $17,000, or less than 0.1% of its $20.2 million; and another spent $390,000, or 3.8% of the $10.3 million it had received. In total these seven municipalities spent only $10.8 million, or approximately 6%, of the total grants received of over $180 million.
- One municipality was given permission to apply its $238 million grant to repay existing capital debt.

At the time of our review, 390 of the 445 municipalities had reported on the amount of funds used as of March 31, 2009. On the basis of these reports—and after removing the $238 million in debt repayments made by the one municipality—only $56 million of the remaining $910 million transferred to municipalities under the Act, or 6.2% of the total, had been spent. The Ministry explained that many municipalities had not used their funding by March 31, 2009, because of construction-timing issues. As well, a number of municipalities were waiting to see if the funds provided under the Act could be used as the municipal portion for any federal stimulus funds available.

To summarize, although $1.1 billion was expensed in the 2007/08 fiscal year, only a fraction of the infrastructure investments have as yet been made.

With respect to the $1.9 billion in other year-end grants, we reviewed seven of the more significant transfers, totalling $1.4 billion or approximately 75% of the total, and noted that approximately $315 million, or only 22%, was spent by the end of the 2008/09 fiscal year.

Enhancing Accountability

Public accountability for any major year-end transfers and future stimulus funding that is to be spent over a multi-year period would be enhanced if the government publicly reported on the status of the money that it provided. Such reporting could be presented in the province's annual report to clearly indicate the extent to which the funds transferred have actually been spent on infrastructure investments.

MINISTRY RESPONSE

Since 2003, investing in infrastructure has been a priority for the government. Infrastructure investments are being made in all key sectors—including highways, roads, transit, environment, health, education, culture, tourism, sport, recreation, and social housing projects. As part of the stimulus initiatives announced in the 2009 Budget, Ontario is supporting not only longer-term infrastructure investment but quick-start projects to help ensure that the stimulus investments are most effective. Of the $32.5 billion in planned infrastructure spending over the next two years, $6.9 billion represents short-term federal–provincial stimulus spending. This stimulus funding was distributed using an application-based process for which a key selection criterion was applicants' attestation of their ability to complete projects by the March 31, 2011 deadline. To date, the federal and provincial governments have already allocated about 75% of the stimulus funding to recipients, and as indicated in the government's 2009 Economic Outlook and Fiscal Review of October 22, more than 650 new projects are already under construction. Many municipalities were awaiting federal and provincial infrastructure stimulus allocations before directing the money provided to them under the *Investing in Ontario Act, 2008* to projects to optimize the value achieved for dollars spent. As announced in the 2009 Ontario Economic Outlook and Fiscal Review, the Ministry of Energy and Infrastructure will be launching a Revitalizing Ontario's Infrastructure website that will allow Ontarians to see a list of infrastructure projects in their community and allow them to track the progress of these projects. This initiative is part of the government's efforts to further enhance transparency and accountability in reporting to the public.

Significant Accounting Issues

The Public Sector Accounting Board sets out the objectives of government financial statements. The first and most fundamental of its standards is that: "Financial statements should provide an accounting of the full nature and extent of the financial affairs and resources which the government controls, including those related to the activities of its agencies and enterprises."

To meet this objective, the Ontario government's annual financial statements currently include, through a consolidation process, the financial position and operating results of more than 300 of its most significant controlled agencies and enterprises. These include its seven government business enterprises, including Ontario Power Generation, the Ontario Lottery and Gaming Corporation, and the Liquor Control Board of Ontario; 47 other government organizations, such as the Ontario Electricity Financial Corporation, Ontario Place, and the Royal Ontario Museum; and, in the broader public sector, each of Ontario's 153 public hospitals, its 103 school boards or local school authorities, and its 24 colleges.

However, there are currently five provincial entities that are considered trusts and are therefore not included in the reporting of the province's financial results. As such, the assets, liabilities, revenues, and expenses of these entities do not form part of the government's consolidated financial statements. However, concerns regarding the deteriorating financial condition of two of these entities—the Workplace Safety and Insurance Board and the Pension Benefit Guarantee Fund—may warrant reconsideration of their exclusion.

WORKPLACE SAFETY AND INSURANCE BOARD

This year, we undertook a review of the Workplace Safety and Insurance Board's (WSIB's) unfunded liability. The result of our review is found in Chapter 3 of this Annual Report. Our review provides information on the significant recent growth in the unfunded liability, the factors contributing to this growth, and WSIB initiatives to control it. As of December 31, 2008, the WSIB's unfunded liability was $11.5 billion—an increase of $3.4 billion, or 42%, from the unfunded liability of $8.1 billion a year earlier. The WSIB is projecting that its unfunded liability will continue to grow over the next few years.

Generally, trusts are excluded from the province's financial results because the province has no access to the assets of the trust and has no responsibility to pay for any liabilities of the trust. However, given the WSIB's current unfunded liability, we believe a re-examination of the WSIB's exclusion from the government reporting entity is warranted. Inclusion of the WSIB in the government's financial reporting would have a material impact on its financial statements. As of March 31, 2009, Ontario's Statement of Financial Position reported provincial liabilities totalling $196.6 billion. These liabilities were offset by government assets of some $83.4 billion, leaving a reported accumulated provincial deficit of $113.2 billion. As of December 31, 2008, the WSIB had liabilities of $24.7 billion, offset by assets of $13.2 billion, leaving it in a net unfunded liability of $11.5 billion. Accordingly, if the WSIB's operations were to be included in the province's financial statements, Ontario's reported accumulated deficit would be increased by more than 10%.

Inclusion of the WSIB would have had an even more dramatic effect on the province's Statement of Operations, which reports the government's total revenues and expenses for the year, thus providing an accounting of the province's annual deficit or surplus. The government reported a surplus of $600 million for the 2007/08 fiscal year and a deficit of $6.4 billion for 2008/09. However, the WSIB, whose results are excluded from the province's expected results, lost $2.1 billion in 2007 and a further $3.4 billion in 2008. Accordingly, inclusion of the WSIB would have had a significant impact on the government's reported results.

Government Control of the WSIB

The Public Sector Accounting Board sets out the principles and criteria governments and auditors should use in determining which organizations' financial affairs and resources are to be included in the government's financial statements. The key criterion for inclusion is that "the government reporting entity should comprise the organizations that are controlled by the government."

Accordingly, the first question to consider is whether the Ontario government controls the WSIB.

PSAB defines control as the "power to govern the financial and operating policies of another organization." This power need not be exercised, yet "control exists by virtue of the government's ability to do so." Whether this control exists is a question of fact to be determined by the particular circumstances of each case, requiring an assessment of the substance of the relationship between the government and the organization, along with the application of professional judgment. PSAB outlines a number of control indicators that should be considered, adding that "it is the preponderance of evidence that would be considered in assessing whether a government controls an organization."

These control indicators are divided into two categories: ones that provide "more persuasive evidence of control" and others that "may provide evidence of control." Figure 6 summarizes our assessment of the WSIB against both sets of indicators. Our assessment makes extensive reference to provisions in the *Workplace Safety and Insurance Act, 1997* (Act, in this section), the WSIB's governing legislation.

Based on the "preponderance of evidence" presented in Figure 6, the government meets the PSAB indicators that indicate it does "control" the WSIB. However, PSAB does provide one exception to its general rule that all controlled entities be included in the government reporting entity—"Trusts administered by a government or government organization should be excluded from the government reporting entity."

Is the WSIB a Trust?

The government of Ontario has classified the WSIB as a trust under this exception. Accordingly, the second question to consider is whether the WSIB is, indeed, a trust. Although PSAB standards provide some guidance to help assess whether this trust classification is appropriate for specific government organizations, the guidance is quite limited. It defines a trust as: "Property that has been conveyed or assigned to a trustee to be administered as directed by agreement or statute. In a trust relationship, the trustee holds title to the property for the benefit of, and stands in a fiduciary relationship to, the beneficiary."

Figure 6: Assessment of Whether, under PSAB Definitions, the Government Controls the Workplace Safety and Insurance Board

Prepared by the Office of the Auditor General of Ontario

Public Sector Accounting Board Control Indicator	Discussion	Assessment
I. More Persuastive Indicators		
The government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization.	The government appoints all WSIB members, including its president, as per section 162(1) of the Act.	indicator met
The government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses.	The government does not have ongoing access to the assets of the WSIB. Rather, most of the WSIB's assets are in an insurance fund that provides benefits to injured workers. However, under the Act, the government has the ability to direct the WSIB's assets' ongoing use to fulfill the purposes of the Act. The most specific section of the Act in this regard is section 167. • Section 167(1) of the Act states: "The Minister may issue policy directions that have been approved by the Lieutenant Governor in Council on matters relating to the Board's exercise of its powers and performance of its duties under this Act." • Section 167(2) then requires the Board to adhere to these policy directions, as follows: "In exercising a power or performing a duty under this Act, the Board shall respect any policy direction that relates to its exercise." The Act makes it clear that the WSIB is to be entirely funded by employer premiums. To date, the WSIB has never received any funds from the province. Section 96(4) of the Act states: "If the Lieutenant Governor in Council is of the opinion that the insurance fund is not sufficient to meet the standards described in subsections (2) and (3), the Lieutenant Governor in Council may direct the Board to increase employers' premiums to the extent that the Lieutenant Governor in Council considers necessary to ensure that the funds meet those standards." However, the Act also makes clear that the government is the ultimate backstop for the WSIB's financial obligations, as section 100, in part, states: "The following rules apply if there is not sufficient money available in the insurance fund to make the required payments as they become due... the Lieutenant Governor in Council may direct that an amount be advanced to the Board from the Consolidated Revenue Fund to make the payments." Given the significant recent unfunded liability, we believe it is no longer certain that the province's "backstop" will not be required. The province also appeared to recognize this as, in referring to responsibility for the unfunded liability of trusts, the 2007 financial statements stated, "they will be discharged by external parties," while the 2008 statements noted that "it is intended they be discharged by external parties." As noted in our review of the WSIB's unfunded liability in Chapter 3, the government does influence the setting of employer premium rates and the level of benefits to be paid. As such, the actions of the government can have a significant impact on the annual operating results of the WSIB and its unfunded liability position.	indicator met

Public Sector Accounting Board Control Indicator	Discussion	Assessment
The government holds the majority of the voting shares that confers the power to govern the financial and operating policies of the organization.	As indicated above, the government appoints the WSIB's chair, its president, and all other board members. Also, as indicated above, section 167(1) of the Act gives the Minister broad powers to direct the WSIB, and the WSIB is obligated under the Act to adhere to such orders. The combination of these two powers is equivalent to the "golden share" concept, which the Public Sector Accounting Board defines as, "powers or rights generally exceeding those normally associated with the holder's ownership interest or representation on the governing body."	indicator met
The government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations.	The original Worker's Compensation Board (WCB) and the more recent WSIB were both created by the provincial government through legislation. Unlike some of the other entities the government consolidates, such as many of Ontario's public hospitals, the WSIB was not established by a party outside the government, nor has it any outside ownership or equity interests. Given that the WSIB was created solely by the government of Ontario and is accountable only to it, and although highly unlikely, the government has the power to dissolve it, solely at its discretion. The control criteria clearly states that the government merely has to have the power and does not require any assessment of whether this power would be exercised.	indicator met
II. Other Indicators		
The government has the power to provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members.	As indicated above, under section 162.1, the government appoints all members of the WSIB's governing body.	indicator met
The government has the power to appoint or remove the CEO or other key personnel.	Under section 162(1)(b), the government appoints the WSIB's president.	indicator met
The government has the power to establish or amend the mission or mandate of the organization.	The government has the power to amend the WSIB's underlying legislation. For instance, in 1997, the *Workers' Compensation Act* was significantly revised, including revisions to the board's mission and mandate, as well as its name.	indicator met
The government has the power to approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis.	No section of the Act speaks directly to the government's power to approve the WSIB's business plans or budgets. However, section 167, as indicated above, requires the WSIB to adhere to any policy direction issued by the government. This section provides the government with sufficient power to direct any aspect of the WSIB's operations, including the specifics of its business strategy or its spending plans.	indicator met
The government has the power to establish borrowing or investment limits or restrict the organization's investments.	Under section 97(4), the WSIB's investments are restricted to those authorized under the *Pension Benefits Act*, another provincial statute. Section 166 requires that the WSIB and the Minister enter into a memorandum of understanding and requires that the memorandum state that "the Board must give the Minister an annual statement of its investment policies and goals." The government also has the authority to restrict the WSIB's investments further at any time by virtue of section 167, which allows it to issue policy direction to the Board.	indicator met

Public Sector Accounting Board Control Indicator	Discussion	Assessment
The government has the power to establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining, or deployment of resources.	Historically, the government has left it up to the WSIB to establish its internal administration policies. However, the Act does provide the government with the power to influence these policies should it so desire. As noted earlier, section 167(1) states: "The Minister may issue policy directions that have been approved by the Lieutenant Governor in Council on matters relating to the Board's exercise of its powers and performance of its duties under this Act." This section is sufficiently broad to cover any of WSIB's management policies, such as those to relating to accounting practices or employee compensation. The memorandum of understanding requirements under section 166 are also another legislative mechanism by which the government can (and does) establish or amend WSIB's management policies. With respect to administrative matters, section 131(1), in part, states: "…With the approval of the Lieutenant Governor in Council, the Board may make rules governing its practice and procedure."	indicator met

After this somewhat legalistic definition, PSAB's commentary on trusts is limited to a few subsequent paragraphs. It says:

> To meet the definition, the property conveyed or assigned to the government or government organization acting as trustee must be provided to fulfill a particular objective of the donor of the property conveyed or assigned. The government or government organization would merely administer the terms and conditions embodied in the agreement and has no unilateral authority to change the conditions set out in the trust indenture.

Furthermore, PSAB also says: "Often the term 'trusts' is applied to assets earmarked as a result of a government policy decision when no trust liability exists. Such assets are special funds that comprise part of the government reporting entity and would be consolidated."

To supplement this guidance, we reviewed the characteristics of both private- and public-sector trusts and assessed their resemblance to the WSIB. The WSIB does not operate like a trust. One feature of almost all trusts is the absence of significant business risk. Property is almost invariably conveyed to trusts for limited time periods and for eventual disposition under specified conditions to one or more beneficiaries known to and specified by the donor. The trust manages the conveyed property until the conditions for transfer specified by the donor arise. Accordingly, for every asset of significance held by a trust, there is a comparable offsetting liability to a specified beneficiary. Given this offsetting nature of trust assets and liabilities, exclusion of trusts administered by a government from its financial statements makes sense, as inclusion would unnecessarily clutter the statements with extraneous "noise" on both sides of the balance sheet that would be of little use in assessing the government's own financial position or condition.

The Office of the Public Guardian and Trustee is arguably the best example of a trust administered by the province. This government office manages the assets of financially incapable individuals and the estates of persons who die intestate without adult heirs. It also manages funds for minors until they reach the age of majority and administers the property of dissolved corporations. Finally, it acts as the depository for all monies, mortgages, and securities paid into the Superior Court of Justice awaiting court disposition. As of March 31, 2009, this office held total assets and offsetting liabilities of some $1.3 billion. These were appropriately excluded from the province's consolidated statement of financial position.

Another key PSAB requirement states that to be a trust the property conveyed must "fulfill a particular objective of the donor," and that the government as trustee must have "no unilateral authority to change the conditions set out in the trust indenture." In fact, the Ontario government has unilateral authority, which it exercises periodically, to legislate changes to, among other things, the benefits paid to the WSIB's "beneficiaries."

Particularly given the recent significant increase in the size of the unfunded liability, we are becoming increasingly of the opinion that the government is running an insurance business through the WSIB rather than administering a trust. If so, the government is subject to the same business risks as the owners of any insurance company. Like insurance companies, the WSIB charges and collects premiums that it establishes based on its actuarial projections of expected future claims. These projections take into account both past claims experience and management's beliefs about the future. These premiums are not then maintained for eventual return to a beneficiary specified by the donor. Rather, as with insurance organizations, premiums are pooled in insurance funds and invested. Significant business risk arises from this operation, because the claims that may eventually arise and have to be paid from insurance funds may far exceed the value of premiums collected and the investment returns these premiums were able to generate. That the WSIB is subject to considerable business risk is obvious from the very fact that it has now accumulated an unfunded obligation that is $11.5 billion and growing.

The bottom line is that if the WSIB was operating like a true trust, it would not have such a significant unfunded liability.

There is a final point to be made regarding this trust classification issue. Even if one accepts the classification of the WSIB as a trust, it is worth examining the accounting standards for defined benefit pension plans, another type of trust administered by most governments. Unlike trusts such as the Office of the Public Guardian and Trustee, sponsors of defined benefit pension plans are also subject to significant business risk. This is because defined benefit pension plans ultimately provide their beneficiaries with pensions that are not directly and necessarily related to or derived from the specific contributions received on their behalf. Pensions payable from such defined benefit plans are typically based on a formula driven by such factors as the employee's average salary during the years just preceding his or her retirement and the number of years of employment service. The pension obligation arising from the application of this formula may differ significantly in value from the value of contributions received on the employee's behalf and the investment returns the plan has been able to earn on these contributions over the course of the employee's career.

To reflect these business risks appropriately, while continuing to respect the fact that the assets in pension plans are held in trust, accounting standards for defined benefit pension plans require that the plan sponsors include on their statement of financial position not all of the plan's assets and liabilities, but rather only the net surplus or shortfall in the pension plans they sponsor. A pension asset on the plan sponsor's books reflects the fact that the assets are currently in excess of its obligations, while a pension liability reflects the fact that its liabilities are currently in excess of its assets.

The government of Ontario applies these standards in accounting for each of the defined benefit pension plans it sponsors, the three largest of which are the Public Service Pension Plan, the Ontario Public Service Employees Union Pension Plan, and the Ontario Teachers' Pension Plan. As of March 31, 2009, the province in its consolidated financial statements disclosed that its pension benefit liabilities, primarily for these three plans, amounted to $68.1 billion. The province further disclosed that these liabilities were offset by plan fund assets, unamortized actuarial gains, and other adjustments of $72.9 billion, resulting in a net asset position for the government of $4.8 billion. This $4.8 billion net asset was appropriately included along with all the other government assets on its statement of financial position.

Government Accountability

No other jurisdiction in Canada has a workers' compensation board with such a large unfunded liability. It is often said that what gets measured gets more attention than what does not. Inclusion of the WSIB in the government reporting entity would mean that its annual surplus or deficit would form part of the province's overall annual surplus or deficit, the prime measure used by the media, the public, and the government itself of its overall fiscal performance. It would also mean that the WSIB's unfunded liability would form part of the government's overall accumulated deficit, a key measure of its net financial position. Exclusion may convey the message that the WSIB's financial challenges are not the government's problem. Exclusion may also provide less of an incentive for the government to help address the WSIB's financial problems. Consequently, and notwithstanding the technical accounting arguments for inclusion or exclusion, inclusion of the WSIB in the province's consolidated financial statements would enhance government accountability and transparency.

In conclusion, we believe that, particularly in light of the recent significant increase in the WSIB's unfunded liability, the government should formally re-evaluate its current policy of excluding the WSIB from the province's financial statements.

PENSION BENEFITS GUARANTEE FUND

The Pension Benefits Guarantee Fund (PBGF), established in 1980 under the *Pension Benefits Act* (Act, in this section), is the only fund of its kind in Canada. Its purpose is to act as the guarantor of last resort for certain pension benefits when eligible defined benefit plans are wound up under conditions specified in the Act. The Superintendent of the Financial Services Commission of Ontario is responsible for the administration of the fund.

The PBGF is funded through premiums charged to and paid by private-sector pension plan sponsors. Similar to the WSIB, the PBGF is classified as a trust in the province's consolidated financial statements because PBGF liabilities are not considered to be obligations of the province. As such, its assets, liabilities, and operating results are excluded from the government reporting entity but are disclosed in the notes to the province's consolidated financial statements.

2008/09 Fiscal Year Financial Condition

Similar to our concerns with respect to the WSIB, we believe recent events necessitate a review of the PBGF's exclusion from the financial statements.

As the result of claims made over the last few years, the PBGF has an unfunded liability of over $47 million as of March 31, 2009. This means that bona fide claims exceed the assets available to pay them. This liability position is in spite of the PBGF receiving a $330 million non-interest-bearing loan from the province in the 2003/04 fiscal year. The government has discounted this loan to its effective value of $162 million to reflect its non-interest-bearing nature and its repayment arrangements of $11 million in annual instalments over a 30-year period. Since the $330 million loan was made, the province has provided the PBGF with an additional loan of $30 million.

The PBGF's financial health continues to be of concern because a number of companies sponsoring pension plans are in significant financial distress and could make claims which, according to the notes to the PBGF's March 31, 2009, financial statements, "could significantly exceed [its] existing assets." These potential claims would in all likelihood put the fund in the position where it would be unable to meet its claim obligations or repay its provincial loans. The government has partially recognized this risk by increasing its provision for uncollectible loans in the province's books. This reflects the increasing risk that the PBGF could default on its scheduled future loan repayments.

The current poor financial condition of the PBGF raises the further risk that its remaining liabilities will become the responsibility of the province. The continued direct provincial assistance to the PBGF implies that its trust classification may no longer meet generally accepted accounting standards for treatment as a trust.

The government is fully aware of the PBGF's financial difficulties. Its Expert Commission on Pensions in November 2008 recommended that an examination be conducted to determine the appropriate fees and guarantees needed to ensure the PBGF is governed on self-financing principles. The commission also recommended that the PBGF be administered at arm's length from the pension regulator.

In response to these recommendations, the government has appointed an independent actuary to review the stability and the financial status of the PBGF. Once the study is completed, the government is expected to consider establishing an independent PBGF agency. Its objective would be to ensure that the PBGF operates on sound business principles with coverage and assessment levels that are sustainable over the long term.

The government has since amended the Act to clarify that the PBGF is a self-sustaining fund independent of the government. The amendments include provisions allowing, but not requiring, the government to provide grants or loans to the PBGF. The amended Act also emphasizes that the PBGF's liabilities are limited by its assets.

Similar to our concern about the significant deteriorating financial condition of the WSIB and whether it should continue to be excluded from the province's financial statements, we recommend the government formally re-evaluate the continued exclusion of the PBGF from the province's financial statements.

MINISTRY RESPONSE

The Ministry, in conjunction with the Office of the Auditor General, will review the province's current accounting treatment for the Workplace Safety and Insurance Board and the Pension Benefits Guarantee Fund, taking into consideration the current economic circumstances.

Status of Public Accounts Issues Raised in Prior Years

INTRODUCTION

As noted last year, from time to time my Office and the Ministry of Finance may have differing views on the most appropriate accounting treatment of certain issues. This is not uncommon between the preparers and the auditors of an entity's financial statements, and typically we work together to resolve our differences. As a result, my predecessor and I have been able to issue an unreserved or "clean" opinion on the annual consolidated financial statements of the government since the province first adopted Public Sector Accounting Board standards in the 1993/94 fiscal year—a period of 16 years. In my view, this demonstrates the commitment of the government to prepare consolidated statements in accordance with generally accepted accounting principles for governments.

During this year's audit of the government's consolidated financial statements, we again dealt with a number of accounting issues. Of particular note were two issues raised in prior years where we had a difference of opinion: accounting for certain transfers to the province by other levels of government for investments in provincial capital infrastructure, and accounting for rate-regulated assets and liabilities. Because of the size of the government of Ontario and the dollar value of its transactions, these issues were not significant enough to affect my opinion on the overall fairness of the province's consolidated financial statements. However, we indicated we would continue to work with the Ministry in an attempt to resolve these matters in the 2008/09 fiscal year. Both of these issues are discussed below.

ACCOUNTING FOR CAPITAL TRANSFERS

We noted in last year's Annual Report that the government was not accounting for all capital transfers it received from other levels of government in accordance with PSAB standards. Under these standards, capital transfers should be recognized as revenues when the province incurs the expenditures that make it eligible to receive the grant. We noted the province had received significant federal grants, accumulated over several years, that in our view should have been recognized as revenue because the government had incurred the expenditures making it eligible for the grants in question. However, the recognition of these revenues has been deferred, reflecting the government's view that these revenues should be recognized over the useful lives of the related assets. As of March 31, 2009, these deferred amounts continued to grow but are not yet significant enough to impact the fairness of the consolidated financial statements.

We are awaiting the new standards regarding accounting for capital transfers because the PSAB standards on government transfers are currently being revised.

RATE-REGULATED ASSETS AND LIABILITIES

Rate regulation refers to an arrangement whereby a government-established authority approves the prices that a regulated entity can charge its customers for its products or services. Regulators often prohibit regulated entities from immediately recovering all of their current costs in their current rates, ordering rather that such costs be "deferred" (and recorded as an asset) for recovery in future periods. Rate-regulated accounting practices were developed to recognize the unique nature of regulated entities and these types of transactions.

In last year's Annual Report, we discussed our concerns regarding the use of rate-regulated accounting in the government's consolidated financial statements. The discussion focused on a number of our technical arguments against the practice. Our concerns remain unresolved. However, rather than repeat our previous arguments, this year we would like to approach the issue at a more conceptual level.

A key purpose of government consolidated financial statements is to provide an objective, consistent, comparable, and sound measure of the government's surplus or deficit for the fiscal period and of its accumulated deficit at the end of the fiscal period. Arguably, the essential principle that must be applied to ensure that credible results are arrived at is the use of a consistent appropriate criterion for revenue and expense recognition. This is often referred to as the "basis of accounting." PSAB calls for government financial statements to be prepared using the accrual basis of accounting. Under this approach, revenues are recognized in the periods they are earned, and expenses are recognized in the periods they are incurred.

We fully support the accrual basis of accounting and believe that, with one exception, it is being applied consistently in the government and its consolidated entities. The exception is the government's electricity sector.

The government owns and controls all of the major entities in Ontario's electricity sector, including Ontario Power Generation Inc. (OPG), Hydro One Inc., the Ontario Electricity Financing Corporation, the Ontario Energy Board, and the Ontario Power Authority (OPA). Each of these entities was created by the government to deliver on particular aspects of its overall energy policies. The basis of accounting used by three of these entities—OPG, Hydro One, and OPA—is rate-regulated accounting. The financial results of each of these three entities are combined with those of all other significant government-controlled organizations to arrive at the government's consolidated financial position and results of operation. However, although expenses are recorded when incurred for, all other consolidated entities such as ministries, large Crown agencies, school boards, colleges, and hospitals, electricity entities can recognize certain expenses as assets through the regulatory process.

Although we acknowledge that the use of rate-regulated accounting may be acceptable in the entities' individual financial statements, we believe that using the same basis of accounting as the province for determining its consolidated results would be more conceptually sound. The rationale for allowing certain expenses to be deferred and recorded as assets is that the expenses will be recovered from future revenues from electricity consumers. In essence, the anticipated revenues are being recorded as assets in advance in the accounting of the province.

PSAB standards contain no allowances for the advance recognition of any other types of future revenues such as revenues from taxes, liquor sales or profits, casino revenues or profits, government fees or fines, or any other government revenues that may be as assured or even more assured than future electricity-sector profits. They also contain no allowances for the deferral of any current government costs to future periods, regardless of the degree of certainty that such costs can or will be recovered. In fact, the government's annual reported deficit or surplus would have little meaning if such cost deferrals and future revenues recognition were allowed under PSAB accounting standards. Yet this is what rate-regulated accounting allows for in the electricity sector. And the numbers are significant—the two biggest electricity-sector entities recognized $877 million in rate-regulated assets and $661 million in rate-regulated liabilities between them as of their December 31, 2008, year end.

We believe this issue needs to be specifically addressed by PSAB—not from the perspective of the regulated entity but from the perspective of the government's own consolidated financial statements.

To précis some of the technical arguments we made in last year's Annual Report, we do not believe that rate-regulated assets and liabilities meet the definition of bona fide assets or liabilities under generally accepted accounting principles for governments. We also believe that, from the perspective of the government as opposed to that of the regulated entity, there is no independence of the regulator from the organization being regulated and from the government itself. Both the regulator and the regulated entity are owned and controlled by the government that created them. Without such independence, one could argue that the government itself is deciding what costs do not need to be recognized as expenses rather than applying established accounting principles in making that determination. From this perspective, assets and liabilities arising from rate-regulated gains and losses should be removed as part of the consolidation adjustment process just like all other inter-organizational gains and losses to arrive at a fair presentation of the government's transactions with external parties.

We noted last year that the Canadian Institute of Chartered Accountants was adopting international accounting standards as part of its move to harmonize Canada's accounting practices with those found around the world. At that time, these new international standards did not contain provisions supporting rate-regulated accounting, and the CICA's Accounting Standards Board had indicated that it did not intend to amend these standards with regard to such accounting practices. Rather, it indicated that all assets and liabilities would have to meet the CICA's conceptual framework definitions to be included in financial statements. We were encouraged by these developments because rate-regulated assets and liabilities do not meet these definitions.

However, this year, the International Accounting Standards Board issued an exposure draft that, if approved, would allow rate-regulated entities to continue recognizing regulatory assets and liabilities under certain conditions. This proposed accounting standard will in all likelihood be used by the province's electricity-sector businesses. Accordingly, our hope that our concerns with respect to rate-regulated accounting would be addressed through the adoption of international standards no longer appears as likely. This makes it all the more important for PSAB to address the issue directly and to do so from the perspective of the government's consolidated financial statements. For now, we acknowledge that we have little choice under existing standards but to allow the continued use of rate-regulated accounting in accounting for government business enterprises in the province's consolidated financial statements, even though we question its conceptual basis.

The Government Reporting Entity

FULL LINE-BY-LINE CONSOLIDATION OF THE BROADER PUBLIC SECTOR

Under the Public Sector Accounting Board's reporting entity standard, governments have been permitted to consolidate broader-public-sector (BPS) organizations on a modified equity basis of accounting up to and including the 2008/09 fiscal year. Under modified equity accounting, BPS net assets have been reported as a single line item on the province's Consolidated Statement of Financial Position, and each sector's net expenses are included as a single line on the province's Schedule of Expenses. Currently, there are three BPS sectors that are affected in Ontario: hospitals, school boards, and colleges.

For all fiscal years that commence on or after April 1, 2009, the PSAB standard requires BPS organizations to be fully consolidated. Full consolidation means that the accounts of BPS organizations are to be included using the same accounting policies as the province, with each revenue and expense item, as well as each asset and liability item, being combined with the corresponding item in the province's consolidated financial statements. One key consequence of this line-by-line approach is that the $33.9 billion in BPS tangible capital assets and $15.5 billion in BPS net debt from these three sectors would form part of the province's total capital assets and net debt, respectively.

In January 2009, PSAB extended the transition period for the consolidation of these organizations on a line-by-line basis by one year. The government views a one-line consolidation for these sectors as best representing the bottom-line fiscal accountability of these organizations to the province for managing these public funds.

We reviewed the 2008/09 financial statements of the other provinces to see how other jurisdictions are dealing with this standard and note that the majority of Canadian jurisdictions have already adopted full line-by-line consolidation of their BPS.

We are currently working with the Ministry of Finance on the presentation of these BPS organizations in the province's consolidated financial statements and of the impact on the consolidated financial statements if full line-by-line consolidation is not adopted.

Capital Asset Accounting and Reporting

In January 2003, PSAB revised a 1997 standard setting out the rules for the recognition, measurement, amortization, and presentation of capital assets in a government's financial statements. The standard recommends that governments, in a manner similar to the approach taken in the private sector, record acquired or constructed capital items as assets and amortize their cost to operations over their estimated useful lives.

The government's approach has been to phase in the adoption of these recommendations over time. In its 2002/03 fiscal year, the government valued and capitalized the province's land holdings, buildings, and transportation infrastructure, and for the first time recognized over $13 billion of its net capital investments in these assets. As of March 31, 2009, the province's net investments in these capital assets had grown to $21.7 billion, and these assets are now appropriately recorded on the province's consolidated statement of financial position.

The government has advised us that it is completing the capitalization project for its remaining tangible capital assets, including computer systems, vehicles, aircraft, and marine fleet, in the 2009/10 fiscal year. We have met with ministry officials a number of times to address the scope of this project and the method of valuing and accounting for these assets.

Public Sector Accounting Board Initiatives

This section briefly outlines some of the more significant issues that the Public Sector Accounting Board has been dealing with over the last year that may in future affect the province's consolidated financial statements.

INTRODUCTION

The Canadian Institute of Chartered Accountants' Public Sector Accounting Standards Board (PSAB) has the authority to set accounting standards for the public sector. PSAB is working to address a number of complex financial accounting and reporting issues, including accounting for financial instruments, government transfers, foreign exchange, and how the adoption of International Financial Reporting Standards by government business enterprises and public-sector not-for-profit organizations should be accounted for in the government's consolidated financial statements.

The Accounting Standards Board of the CICA, the national organization responsible for establishing Canadian accounting and financial reporting standards, is implementing a number of financial reporting changes to be used by all publicly traded companies. By 2011, the current Canadian generally accepted accounting principles used to prepare the financial statements of publicly accountable, profit-oriented enterprises will be replaced by an accounting framework set out in International Financial Reporting Standards. The Accounting Standards Board is also reviewing and updating the standards applicable to not-for-profit organizations. These changes reflect the ongoing globalization of financial markets and the movement toward worldwide standards in several areas of business and government.

STANDARDS

Financial Instruments

The province uses financial instruments and derivatives such as foreign-exchange forward contracts, swaps, futures, or options to manage or hedge against risks related to debt it has issued in foreign currencies and/or at variable interest rates. Currently, PSAB guidance on accounting for derivatives is limited to their application in hedging foreign-currency items, such as managing the foreign-currency risk associated with holding a debt repayable in U.S. dollars.

In January 2005, the CICA's Accounting Standards Board approved three new handbook sections relating to such activities: "Financial Instruments," "Comprehensive Income," and "Hedges." Although these handbook sections were developed for the private sector, and governments were not required to apply them, they underscored the need to eventually address these issues from a public-sector perspective. Accordingly, PSAB created a task force to consider how governments should account for financial instruments. One of the key issues it will address is whether changes in the fair market value of derivative contracts, similar to fluctuations in the market value of equities and bonds, should be recognized in a government's financial statements. A key aspect of this issue is whether such changes should affect the determination of a government's annual surplus or deficit.

The main rationale for recognizing changes in the fair market value of financial instruments is to ensure that assets and liabilities of an organization are recognized at their current value rather than their historical acquisition value at the end of each fiscal period. However, if such changes in value were recognized as immediate gains or losses, they could have a significant impact on the organization's annual surplus or deficit, even though such gains or losses may not have been realized and could be reversed in future years.

PSAB issued its exposure draft on financial instruments in September 2009. Among its more significant recommendations is that all gains and losses from fair value re-measurement be recorded in the Statement of Operations and that these re-measurement gains and losses be reported separately from the province's other revenues and expenses so that the province's surplus or deficit clearly distinguishes the impact of re-measurement gains and losses. PSAB notes that the recommendations contained in it will bring the financial accounting and reporting of financial instruments, including derivatives, in line with international developments. These proposed standards are essentially consistent with the accounting used by the private sector.

Foreign Currency Translation

At present, PSAB standards include recommendations allowing gains and losses on foreign-currency-denominated items to be deferred and amortized to operations over time. PSAB notes that its accounting standard is the only one among the major accounting standards used throughout the world that allows deferral and amortization of such foreign-exchange gains and losses, and that this accounting is not consistent with its conceptual framework or asset and liability definitions.

PSAB has indicated that, as part of its plan to address financial instruments, it will need to revisit these recommendations. Specifically, it is expected that the current deferral provisions will be replaced with the requirement that such gains and losses be immediately recognized as re-measurement gains and losses in the determination of the annual surplus or deficit. PSAB has indicated that it intends to approve an exposure draft on foreign currency translation in the near future. We expect it to incorporate the changes discussed above.

Government Transfers

PSAB has been working over a number of years to amend its standard on government transfers to address a number of issues raised by the government community. Although there are a number of issues that need to be addressed, the main issue to be resolved is how multi-year funding for capital transfers provided by one government to another should be accounted for. Given the billions of dollars in government transfers made annually, the revised standard has the potential to significantly affect a government's reported financial results.

A variety of views have been expressed and PSAB has faced challenges in obtaining a consensus on what revisions should be made to the existing standard. The more recent re-exposure draft, issued in April 2009, proposed that operating transfers be recognized as revenue in the period the transfer is authorized and any eligibility criteria is met, unless the transfer gives rise to a liability for a recipient government. The proposal is consistent with PSAB's conceptual framework but allows for more professional judgment in assessing whether a liability exists. PSAB is currently reviewing responses to this second re-exposure draft.

Financial Reporting by Government Not-for-profit Organizations

Currently, government not-for-profit organizations, such as hospitals, colleges, and universities, are directed by PSAB to follow the CICA standards for not-for-profit organizations. The Accounting Standards Board is in the process of evaluating options for future financial reporting and accounting standards for private-sector not-for-profit organizations. In June 2009, the Accounting Standards Board and PSAB issued a joint invitation to comment on financial reporting by not-for-profit organizations. There are a number of financial reporting options available for these entities, and a key issue is whether all not-for-profit organizations should apply the same standards. Although this would enhance comparability, some believe not-for-profit organizations should have the flexibility to choose from alternative sets of standards based on their particular circumstances.

The options for public-sector not-for-profit organizations under consideration include using PSAB standards alone or PSAB standards supplemented by certain CICA not-for-profit standards. Both the Accounting Standards Board and PSAB have rejected developing a set of stand-alone standards to accommodate all not-for-profit organizations.

PSAB has indicated that it intends to issue an exposure draft on this subject in the near future.

Liability for Remediation and Mitigation of Contaminated Sites

Canadian accounting standards currently provide no guidance on accounting for environmental liabilities. In recognition of the unique complexities associated with such liabilities, PSAB approved an environmental liability project in June 2006. As the project progressed, it decided to limit the scope of the project to the development of a proposed accounting standard on the remediation and mitigation of contaminated sites. In January 2009, PSAB approved a statement of principles for this proposed standard and in April 2009 issued it for public comment.

The statement of principles notes that only legal obligations should be recognized as liabilities. Obligations that may arise from intention or policies that are not legally enforceable should not be recognized in the financial statements. PSAB has indicated that the next stage in the process will be to issue an exposure draft on liability for contaminated sites.

Tax Revenue

Given the importance and magnitude of tax revenue, PSAB approved an exposure draft in November 2007 to address many of its unique issues. A re-exposure draft was released in April 2009 that took into account stakeholder responses to the first exposure draft. The re-exposure draft proposes an accounting standard that calls for the recognition of tax revenues when they meet the definition of an asset, are authorized, and the taxable event occurs. PSAB expects to approve a final standard on tax revenues later this year.

Revenue from Exchange Transactions

Revenue in the public sector is generated from both exchange and non-exchange transactions. PSAB is currently addressing certain revenues arising from non-exchange transactions, such as government grants received, in its government transfers project and its tax revenue project. Exchange transactions are not currently defined by PSAB. However, the International Accounting Standards Board (IASB) currently has a project on revenue recognition and has established a definition for exchange transactions as those "in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange." Examples of Ontario government exchange transactions include liquor and lottery ticket sales.

Revenue recognition has a direct impact on the measurement of the surplus and deficit reported by governments. Although governments receive a significant portion of their revenue from non-exchange transactions, many governments still receive a substantial portion of their revenues from exchange transactions, as do government organizations. Accordingly, PSAB approved a project proposal on this topic in June 2009.

GUIDANCE

Assessment of Tangible Capital Assets

In November 2008, PSAB released a statement of recommended practice to assist governments in reporting on their major assets and to improve the comparability and reliability of financial and non-financial information about such assets. It is also intended to assist governments in evaluating their financial condition and their financial and non-financial performance.

Existing guidance on reporting financial and other information about tangible capital assets is limited. Appropriate information about the use and condition of a government's tangible-capital-asset infrastructure assists users in understanding the ongoing maintenance, renewal, and replacement costs associated with this infrastructure. It is therefore a major factor in assessing a government's financial ability to maintain existing levels of services.

Statutory Matters

Under section 12 of the *Auditor General Act*, I am required to report on any Special Warrants and Treasury Board Orders issued during the year. In addition, section 91 of the Legislative Assembly Act requires that I report on any transfers of money between items within the same vote in the Estimates of the Office of the Legislative Assembly.

LEGISLATIVE APPROVAL OF EXPENDITURES

Shortly after presenting its budget, the government tables detailed Expenditure Estimates in the Legislative Assembly outlining, on a program-by-program basis, each ministry's spending proposals. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and presents a report on them to the Legislature. The estimates of those ministries that are not selected for review are deemed to be passed by the Committee and are so reported to the Legislature. Orders for Concurrence for each of the estimates reported on by the Committee are debated in the Legislature for a maximum of two hours and then voted on.

Once the Orders for Concurrence are approved, the Legislature provides the government with legal spending authority by approving a *Supply Act*, which stipulates the amounts that can be spent by ministry programs, typically those set out in the estimates. Once the *Supply Act* is approved, the individual program expenditures are considered to be Voted Appropriations. The *Supply Act* pertaining to the fiscal year ended March 31, 2009, received Royal Assent on April 23, 2009.

The *Supply Act* is typically not passed until well after the start of the fiscal year—and sometimes even after the related fiscal year—but ministry programs require interim funding approval prior to its passage. The Legislature authorizes these payments by means of motions for interim supply. For the fiscal year ending March 31, 2009, the Legislature passed a motion of interim supply on December 6, 2007 that covered the period April 1, 2008 to July 31, 2008. The government also passed two acts allowing interim appropriations—the *Interim Appropriation Act, 2008*, and the *Supplementary Interim Appropriation Act, 2008*. These two acts received Royal Assent on May 14, 2008, and November 27, 2008, respectively, and authorized the government to incur up to $87.5 billion in public service expenditures, $2.6 billion in investments in capital assets, and $195.9 million in legislative office expenditures. Both acts were made effective as of April 1, 2009, and provided the government with sufficient temporary appropriation authority to allow the government to incur expenditures from April 1, 2008 to March 31, 2009. The motion of interim supply provided the government with temporary approval to incur expenditures until the *Interim Appropriation Act, 2008* received Royal Assent.

Because the legal spending authority under the *Interim Appropriation Act, 2008* and the *Supplementary Interim Appropriation Act, 2008* was intended to be temporary, the acts were repealed under the *Supply Act, 2009*, and the authority to incur expenditures provided under the acts were subsumed into the authority provided under the *Supply Act, 2009*.

SPECIAL WARRANTS

If motions for interim supply cannot be approved because, for instance, the Legislature is not in session, section 7(1) of the *Treasury Board Act, 1991* allows for the issuance of Special Warrants authorizing the incurring of expenditures for which there is no appropriation by the Legislature or for which the appropriation is insufficient. Special Warrants are authorized by Orders-in-Council approved by the Lieutenant Governor on the recommendation of the government.

There were no Special Warrants issued for the fiscal year ended March 31, 2009.

TREASURY BOARD ORDERS

Section 8(1) of the *Treasury Board Act, 1991* allows the Treasury Board to make an order authorizing expenditures to supplement the amount of any voted appropriation that is expected to be insufficient to carry out the purpose for which it was made. The order may be made only if the amount of the increase is offset by a corresponding reduction of expenditures to be incurred from other voted appropriations not fully spent in the fiscal year. The order may be made at any time before the books of the government of Ontario for the fiscal year are closed. The government considers the books to be closed when any final adjustments arising from our audit have been made and the Public Accounts have been tabled in the Legislature.

Subsection 5(4) of the *Treasury Board Act, 1991* allows the Treasury Board to delegate to any member of the Executive Council or to any public servant employed under the *Public Service of Ontario Act, 2006* any power, duty, or function of the board, subject to limitations and requirements that the board may specify. For the fiscal year ended March 31, 2009, the Treasury Board delegated its authority for issuing Treasury Board Orders to ministers for making transfers between programs within their ministries and to the Chair of the Treasury Board for transfers between programs in different ministries and making supplementary appropriations from contingency funds. Supplementary appropriations are Treasury Board orders whereby the amount of an appropriation is offset by reducing the amount available under the government's centrally controlled contingency fund.

Figure 7 summarizes the total value of Treasury Board Orders issued for the past five fiscal years. Figure 8 summarizes Treasury Board Orders for the fiscal year ended March 31, 2009, by month of issue.

According to the Standing Orders of the Legislative Assembly, Treasury Board Orders are to

Figure 7: Total Value of Treasury Board Orders Issued, 2004/05–2008/09 ($ million)

Source of data: Treasury Board

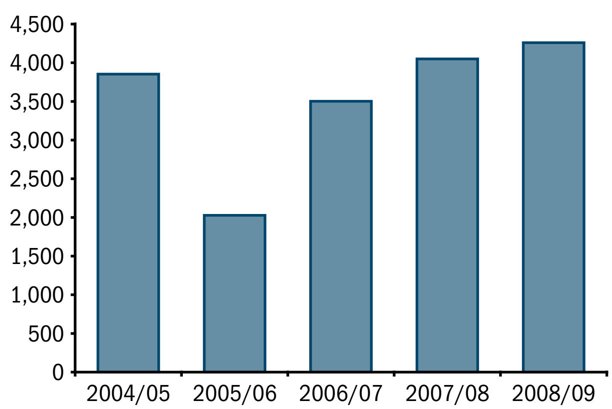


Figure 8: Treasury Board Orders by Month of Issue, 2008/09

Source of data: Treasury Board

Month of Issue	#	Authorized ($)
April 2008–February 2009	67	2,436,569,000
March 2009	22	1,293,912,900
April 2009	18	65,003,200
September 2009	2	464,855,800
Total	**109**	**4,260,340,900**

be printed in *The Ontario Gazette*, together with explanatory information. Orders issued for the 2008/09 fiscal year are expected to be published in *The Ontario Gazette* in December 2009. A detailed listing of 2008/09 Treasury Board Orders, showing the amounts authorized and expended, is included as Exhibit 3 of this report.

TRANSFERS AUTHORIZED BY THE BOARD OF INTERNAL ECONOMY

When the Board of Internal Economy authorizes the transfer of money from one item of the estimates of the Office of the Assembly to another item within the same vote, section 91 of the *Legislative Assembly Act* requires that we make special mention of the transfer(s) in this Annual Report.

Accordingly, with respect to the 2008/09 Estimates, the following transfers were made within Vote 201 and Vote 202, respectively:

From:	Item 2	Office of the Clerk	$ 20,700
To:	Item 3	Legislative Services	$ 20,700
From:	Item 10	Members' Office Support Services	$ 132,200
To:	Item 8	Caucus Support Services	$ 132,200
From:	Item 2	Office of the Information and Privacy Commissioner	$ 30,400
To:	Item 1	Environmental Commissioner	$ 30,400

UNCOLLECTIBLE ACCOUNTS

Under section 5 of the *Financial Administration Act*, the Lieutenant Governor in Council, on the recommendation of the Minister of Finance, may authorize an Order-in-Council to delete from the accounts any amounts due to the Crown that are deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2008/09 fiscal year, receivables of $390.2 million due the Crown from individuals and non-government organizations were written off (in 2007/08, the comparable amount was $199.6 million). The major portion of the write-offs related to the following:

- $138 million for uncollectible corporate tax (2007/08 – $59.8 million);
- $126.5 million for uncollectible retail sales tax (2007/08 – $92.4 million);
- $40.9 million for uncollectible motor fuel, tobacco, and land transfer tax (2007/08 – $0.5 million);
- $25.9 million for uncollectible employer health tax (2007/08 – $10.4 million);
- $15.7 million for uncollectible Criminal Code fines (2007/08 – $7.3 million);
- $14.9 million for uncollectible receivables under the Student Support Program (2007/08 – $9.9 million); and
- $12 million for uncollectible receivables under the Ontario Disability Support Program (2007/08 – $5.6 million).

Volume 2 of the 2008/09 Public Accounts summarizes the write-offs by ministry. Under the accounting policies followed in the preparation of the consolidated financial statements of the province, a provision for doubtful accounts is recorded against accounts receivable balances. Accordingly, most of these write-offs had already been expensed in the government's consolidated financial statements. However, the actual deletion from the accounts required Order-in Council approval.