Chapter 2

Public Accounts of the Province

1.0 Summary

The Consolidated Financial Statements for the Province of Ontario present fairly the Province's annual deficit, net debt and accumulated deficit for the year ended March 31, 2016—but not for the prior fiscal year. Consequently, we issued a qualified audit opinion.

This issue stems from the correction of an error in the Province's accounting for pension assets of pension plans where the government is a joint sponsor. To the government's credit, it made the difficult and appropriate decision to properly adjust the statements for 2015/16. However, the prior year's comparative figures in the Province's consolidated financial statements were not adjusted.

Restating the prior year comparative figures is necessary to conform to standards of the Canadian Public Sector Accounting Board (PSAB) and, just as significantly, better convey to users of the statements that the impact on prior years' figures needs to be considered when looking at past financial trends.

We were puzzled by the approach taken by Treasury Board Secretariat and the Ministry of Finance in discussions with us during the audit regarding the accounting error. The government properly made the adjustment in the current year despite publicly disagreeing with the accounting treatment presented in its own financial statements. It also disclosed in a note to the financial statements that this reflected the Auditor General's interpretation of PSAB standards.

The government had sought external accounting and legal advice in August and September, but was still unable to provide us with an adequate position paper supporting its view that pension assets should continue to remain as an offset to pension liabilities on the Province's consolidated financial statements.

The accounting issue stems from the fact that the Province does not have unilateral access to and control of the pension plan assets. There is no agreement with the joint sponsor to provide this. Basically, unrestricted access to assets of any kind, whether they are pension assets or not, is required under generally accepted accounting principles in order to have an asset recorded in the financial statements.

The ultimate responsibility for the decision on the application of PSAB standards for the specific transaction described above rests with management—in this case, Treasury Board Secretariat and the Ministry of Finance acting for the Government—as preparers of the financial statements, who should consult with the Auditor General of Ontario as the financial statement auditors for the Province. As the auditor, we provide an opinion on the statements prepared by management. Thus, accounting decisions rest with management but the opinion decision rests with the Auditor General.

Equally unusual was that the government chose to enact an unnecessary regulation that only partially complied with PSAB standards, presumably to avoid a qualification by the Auditor General on the 2015/16 annual results.

In the past, we cautioned that the government had passed legislation to allow it to legislate accounting treatments through regulations whenever it wanted, rather than follow PSAB standards. We continue to caution that the use of legislated accounting treatments by the government on future transactions, or the introduction of further legislated accounting treatments, could increase the risk that the future financial results of the province may not be fairly stated.

It is our view that Canadian generally accepted accounting standards (i.e. PSAB standards) are the most appropriate for the Province to use in preparing the consolidated financial statements because they ensure that information provided by the government about the surplus and the deficit is fair, consistent and comparable to data from previous years and from peer governments. This allows all legislators and the public to better assess government management of the public purse.

Additional Issues

Increasing Audit Risk—The actions taken by the Government in releasing the consolidated financial statements late and without the audit opinion of the Auditor General, while also publicly disagreeing with an accounting issue before providing the Auditor General with information needed for her to issue an audit opinion, could be perceived by some as an attempt to undermine the role of the Office of the Auditor General. We note that materials were likely already printed, and a plan was likely already in place to publicly release the consolidated financial statements without the Auditor General's opinion, when we met with the Ministers of Treasury Board and Finance, their Chiefs of Staff and their Deputy Ministers on the morning of October 3, 2016, to further discuss the pension asset accounting issue. Yet nothing was mentioned at the meeting about the planned release later that day. Under Canadian Auditing Standards, the actions taken by government and the preparers of the consolidated financial statements toward financial reporting require us to reassess audit risk. Going forward, our Office will need to approach the audit of the consolidated financial statements with increased professional skepticism and will assess the need for expanded audit procedures.

Increasing Debt Burden—The Province's growing debt burden remains a concern this year, as it has been since we first raised the issue in 2011. This year, as in the past, we focus on the critical implications of the growing debt for the Province's finances.

Consistent with our commentary last year, we take the view that the government should provide legislators and the public with long-term targets for addressing Ontario's current and projected debt, and we again recommend that the government develop a long-term debt-reduction plan.

Use of U.S. Generally Accepted Accounting Principles (U.S. GAAP) Financial Results in Ontario's Financial Statements—We are carefully watching the financial impact on the Province's consolidated financial statements of the government's decision to consolidate Ontario Power Generation (OPG) and Hydro One's financial results based on U.S. GAAP instead of consolidating their financial results based on International Financial Reporting Standards (IFRS), which require the use of PSAB standards. We believe that the differences between the two standards could lead to material accounting differences, potentially as early as the 2016/17 fiscal year.

Increasing Public Communications on the Trillium Trust and the Greenhouse Gas Reduction Account—The Trillium Trust was established in 2014, under the *Trillium Trust Act, 2014* as an account within the consolidated revenue fund that will be used by the government to track transit and transportation expenditures against an allocation of funds from the sale of provincial assets. The new *Climate Change Mitigation and Low-Carbon Economy Act, 2016*, will take effect in January 2017, creating new Greenhouse Gas Accounts that will begin tracking revenues from the Province's cap-and-trade system. Because there will be increased public communications on the use of these accounts, we will, in the coming year, audit compliance with the *Trillium Trust Act* and the *Climate Change Mitigation and Low-Carbon Economy Act, 2016*, with respect to transactions through these two consolidated revenue fund accounts.

Pension Note Disclosure Needs Improvement and Pension Assumptions Could be Re-Assessed—Based on additional research we conducted this year, we have recommended that the Province expand the pension plan disclosures in its consolidated financial statements and revisit the reasonableness of its pension assumptions.

This chapter contains 10 recommendations, consisting of 15 actions, to address our findings.

2.0 Background

Ontario's Public Accounts for the fiscal year ending March 31, 2016, were prepared under the direction of the Minister of Finance, as required by the *Financial Administration Act* (Act), and the President of the Treasury Board. The Public Accounts consist of the Province's Annual Report, including the Province's consolidated financial statements, and three supplementary volumes of additional financial information.

The government is responsible for preparing the consolidated financial statements for the Province of Ontario and ensuring that this information, including many amounts based on estimates and judgment, is presented fairly. The government is also responsible for ensuring that an effective system of internal controls, with supporting procedures, is in place to authorize transactions, safeguard assets and maintain proper records.

Our Office audits these consolidated financial statements. The objective of our audit is to provide reasonable assurance that the statements are free of material misstatements—that is, free of significant errors or omissions. The consolidated financial statements, along with the Auditor General's Independent Auditor's Report, are included in the Province's Annual Report.

The Province's 2015/16 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 ended March 31, 2016. Providing such information is intended to enhance 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**—unaudited statements from all ministries and a number of schedules providing details of the Province's revenue 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 audited financial statements; and
- **Volume 3**—detailed unaudited schedules of ministry payments to vendors and transfer-payment recipients.

Our 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 within 180 days of the end of the fiscal year. The cut-off date for this year was September 27, 2016. The three supplementary volumes must be submitted to the

Lieutenant Governor in Council within 240 days of the end of the fiscal year. Upon receiving these documents, the Lieutenant Governor in Council must lay them before the Legislative Assembly or, if the Assembly is not in session, make the information public and then lay it before the Assembly within 10 days of the time it resumes sitting.

This year, the government delayed its tabling of its Annual Report and, on October 3, 2016, the government took the unprecedented and unnecessary step of releasing the Province's Annual Report and Consolidated Financial Statements without the Auditor General's opinion. In our view, this delay was not the result of an extraordinary circumstance—the Province fully controlled the release date of the financial statements and delayed making a decision on its accounting for pension assets.

We were disappointed with the government's decision to do this. In our view, it is not good public policy for the government to release unaudited consolidated financial statements because the members of the Legislative Assembly and public have no way of knowing whether the amounts presented in the Province's consolidated financial statements are presented fairly.

The Auditor General finalized her audit opinion on the March 31, 2016, consolidated financial statements once the government made its decision on the accounting for pension assets in its financial statements known to our Office by publicly releasing its unaudited consolidated financial statements. When the government released these unaudited financial statements, the Auditor General subsequently forwarded her Independent Auditor's Report to the government on October 5, 2016. The next day, the government submitted the province's 2015/16 Annual Report and Consolidated Financial Statements, along with the Auditor General's Independent Auditor's Report, and the three Public Accounts supplementary volumes to the Lieutenant Governor in Council. The Auditor General's audit opinion on the statements was qualified because the 2014/15 comparative figures were not restated to address an error in the accounting treatment of certain public-sector pension assets, and the Financial Statement Discussion and Analysis accompanying the audited financial statements did not reflect this restatement either. A qualified opinion is a serious matter.

This is discussed in more detail in **Section 3.0**—the province's 2015/16 Consolidated Financial Statements.

3.0 The Province's 2015/16 Consolidated Financial Statements

3.1 Auditor's Responsibilities

As the independent auditor of the Province's consolidated financial statements, the Auditor General's objective is to express an opinion on whether the financial statements are free of material misstatements and are prepared in accordance with standards of the Canadian Public Sector Accounting Board (PSAB) so that they give a true and fair view under PSAB standards. It is this independence, combined with the obligation to comply with the established Canadian Auditing Standards (CAS) and relevant ethical requirements, which allows the Auditor to issue an opinion that provides users with a greater degree of confidence in the financial statements.

To enable the Auditor General to form this opinion, our Office collects sufficient appropriate audit evidence and evaluates it to determine whether the financial statements are free of material misstatements. This includes assessing the government's preferred accounting treatment over certain transactions and analyzing its appropriateness under PSAB standards.

An assessment of what is material (significant) and immaterial (insignificant) is based primarily on our professional judgment. In making this assessment, we seek to answer the following question: "Is this error, misstatement or omission significant enough that it could affect decisions made by users of the Province's consolidated financial statements?" If the answer is yes, then we consider the error, misstatement or omission as material.

To help us make this assessment, we determine a materiality threshold. This year, as in past years, and consistent with most other auditors in provincial jurisdictions, we set our threshold at 0.5% of the greater of government expenses or revenue for the year.

Our audit is conducted on the premise that management has acknowledged certain responsibilities that are essential to the conduct of the audit in accordance with Canadian Auditing Standards. These responsibilities are discussed next.

3.2 Management's Responsibilities

The auditor's report distinguishes the responsibilities between management and the auditor. Management is responsible for the preparation of the financial statements and the auditor examines the financial statements in order to express an opinion. The division of responsibility between the two roles is fundamental and preserves the auditor's independence, a cornerstone of the auditor's report.

In addition to the preparation of the financial statements and the relevant internal controls, management is also required to provide the auditor with all information relevant to the preparation of the financial statements, additional information that the auditor may request, and unrestricted access to those within the entity if the auditor determines it is necessary to obtain audit evidence. The Canadian Auditing Standards are clear on these requirements, and the fulfilment of these is communicated to the auditor in the form of a signed management representation letter at the end of the audit.

When an accounting transaction occurs, it is management's responsibility to be proficient in identifying the applicable standard(s), the implications on the transactions, decide on an accounting policy and ensuring that the financial statements present the transaction in accordance with the applicable financial reporting framework. The auditor must also be proficient in the applicable financial reporting framework in order to form an independent opinion on the financial statements and may perform similar procedures in identifying the applicable standard(s) and understanding the implications on the accounting transaction, but does not decide on the accounting policy or the accounting entries for the organization. These decisions are in the hands of management—in this case, Treasury Board Secretariat and the Ministry of Finance, both with support from the Office of the Provincial Controller Division.

When there are disagreements with the application or adequacy of accounting policies, the auditor assesses the materiality or significance of the matter in forming the audit opinion. If the issue is material, it would result in a qualified opinion in which the auditor concludes that the financial statements are fairly presented except for the items disclosed in the basis for the qualification. Again, this distinguishes the role of management and auditor such that the auditor examines the financial statements to express an opinion whereas management prepares the financial statements.

The Office of the Auditor General may make suggestions about the financial statements but this does not change management's responsibility for the financial statements. Similarly, the government may seek external advice on accounting treatments of certain transactions. In such situations, the government still has the ultimate responsibility for the decisions made, and the use of external advisers does not diminish or change the government's accountability as the preparer of its consolidated financial statements.

3.3 The 2015/16 Audit Opinion

The *Auditor General Act* requires that we report annually on the results of our examination of the Province's consolidated financial statements. The Independent Auditor's Report to the Legislative Assembly on the Province's Consolidated Financial Statements for the year ended on March 31, 2016 reads as shown on the following pages:

Office of the Auditor General of Ontario
Bureau du vérificateur général de l'Ontario

Independent Auditor's Report

To the Legislative Assembly of the Province of Ontario

I have audited the accompanying consolidated financial statements of the Province of Ontario, which comprise the consolidated statement of financial position as at March 31, 2016, and the consolidated statements of operations, change in net debt, change in accumulated deficit and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

The Government of Ontario (Government) is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as the Government determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Government, as well as evaluating the overall presentation of the consolidated financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

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–2 –

Basis for Qualified Opinion

As at April 1, 2015, the Province increased the opening accumulated deficit by $9.154 billion to correct for an error in prior periods in its valuation allowance for an accrued benefit pension asset included in the liability for pensions and other employee future benefits. As reflected in the consolidated financial statements and described in Note 18, the Province has not restated its 2015 comparative period to reflect the correction of the error which constitutes a departure from Public Sector Accounting Standards. Accordingly, in the comparative period, opening accumulated deficit would have increased by $8.201 billion, education expense would have increased by $956 million, general government and other expense would have decreased by $3 million, annual deficit would have increased by $953 million and ending accumulated deficit would have increased by $9.154 billion.

Qualified Opinion

In my opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Province of Ontario as at March 31, 2016, and the consolidated results of its operations, change in its net debt, change in its accumulated deficit and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Other Matter

I draw attention to the Province's Financial Statement Discussion and Analysis that has also not been restated for the effects on the comparative periods of the error in the valuation allowance for an accrued benefit pension asset included in the liability for pensions and other employee future benefits, as discussed in the Basis for Qualified Opinion paragraph above.

Toronto, Ontario
October 5, 2016

Bonnie Lysyk, MBA, CPA, CA, LPA
Auditor General

This year, our audit opinion on the Province's consolidated financial statements is qualified. This means that based on our audit work, we have concluded that the Province's consolidated financial statements for 2015/16 are fairly presented, except for the item disclosed in the basis-for-qualified-opinion paragraph.

The Auditor General's qualification this year arises from an error in the Province's accounting related to the Ontario Teachers' Pension Plan and the Ontario Public Sector Employees' Union Pension Plan presented in the comparative results for 2014/15. The significant rise in the value of the pension assets reported in the consolidated financial statements in recent years triggered an in-depth review by our Office.

We encountered considerable challenges this year in our audit work on the pension assets. Our Office worked diligently with the Office of the Provincial Controller (OPCD), Treasury Board Secretariat and Ministry of Finance to secure their written position paper of their opinion on the proper accounting treatment. To date, their complete analysis on the recognition and valuation of pension assets has not been provided to us, even after OPCD sought and received external advice. Throughout the audit, we received relevant pension information gradually and on a piecemeal basis from OPCD. It was difficult for us to appropriately assess the government's accounting position with new and not always applicable information being presented to us. At the end of the audit, in our view, OPCD was unable to adequately support their position that no adjustment to record a valuation allowance against the pension assets was actually needed.

However, although the government correctly adjusted the March 31, 2016, pension liability and pension expense for the current year ended March 31, 2016, the 2014/15 comparative figures were not restated to correct for the related prior period adjustment. A discussion of the accounting treatment of a pension asset is provided in **Section 3.9**. We determined that the pension asset adjustment impact on the comparative year in the financial statements was material and this is the basis for the Auditor General's qualified opinion.

The Auditor General has also included an "other matter" paragraph in the Independent Auditor's Report this year to point out that, in addition to making it difficult to compare 2015/16 to 2014/15, the error may also have an impact on interpretation of trends in previous years that are reflected in the Province's financial statement discussion and analysis.

3.4 Pension Assets and the Consolidated Financial Statements

At issue this year was the Province's accounting treatment of pension assets related to the jointly-sponsored Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union (OPSEU) Pension Plan. As at March 31, 2016, the government recorded pension assets from OTPP and OPSEU of $10.147 billion and $521 million, respectively, for a total of $10.668 billion.

On the consolidated statement of financial position, the pension asset is grouped in the pensions and other employee future benefits liability line item. The total pension assets in OTTP and OPSEU of $10.668 billion, is offset by $1.356 billion of accrued liabilities from other pension plans, which results in a net accrued pension asset of $9.312 billion before considering any valuation allowance. The $9.312 billion pension asset is further offset by other employee future benefits liabilities of $10.751 billion (all figures before valuation allowance). After applying the valuation allowance of $10.668 billion, this results in total pensions and other employee future benefits liability of $12.107 billion reported on the consolidated statement of financial position, as illustrated in **Figure 1**.

Before a pension asset is recognized, the Province, as a sponsor, must first consider the limit on the carrying amount of an accrued pension asset. The accrued pension asset cannot exceed the expected future benefit the Province can realize

Figure 1: Pension and Other Employee Future Benefits Liability (Asset) as at March 31, 2016

Sources of data: 2015/16 Consolidated Financial Statements

	2016 Pensions ($ million)	2016 Other Employee Future Benefits ($ million)	2016 Total ($ million)	2015 Total ($ million)
Obligation for benefits	117,542	10,999	128,541	124,726
Less: plan fund assets	(141,749)	(562)	(142,311)	(129,880)
Unamortized actuarial gains	12,649	305	12,954	6,084
Adjustments[1]	2,246	9	2,255	2,221
Accrued liability (asset)[2]	**(9,312)**	**10,751**	**1,439**	**3,151**
Valuation Allowance[2]	10,668	–	10,668	–
Total	**1,356**	**10,751**	**12,107**	**3,151**

1. Adjustments for pensions consists of:
   i) differences for amounts reported by the pension plans at December 31, instead of the province's year-end of March 31;
   ii) unamortized difference between employer and employee contributions for jointly sponsored pension plans; and
   iii) amounts payable by the province that are reflected as contributions in the pension plan assets.
2. Valuation allowances are related to the pension assets for the Ontario Teachers' Pension Plan and for the OPSEU Pension Plan.

from the asset. PSAB standards provide guidance on this and require an annual calculation of the "pension asset ceiling" as a test to determine if the pension asset is impaired (this is explained further in **Chapter 4**, **Section 4.01**, where we discuss sponsor accounting for a pension asset).

We contacted OPCD with concerns regarding the pension asset issue on June 8, 2016 and formally raised the pension asset accounting issue in our finalized Audit Planning Report to Treasury Board Secretariat and the Ministry of Finance dated June 24, 2016. It became apparent to us that management, as preparers of the financial statements, did not have documentation available to support their original decisions on the accounting treatment to support recognition of $10.668 billion of pension assets. A partial response was provided to us in late August, and this was the beginning of numerous meetings with OPCD, Treasury Board Secretariat, Ministry of Finance and their external advisers into September on the issue.

We co-operated with all parties to address the accounting treatment of the pension assets. However, we were provided at times with partial answers that did not fully address our questions and requests, thus prolonging the issue. In addition, the Province engaged external advisers to assist in this matter and, in our view, the advice received did not support the province's recognition of the $10.668 billion pension asset. Based on the information that we had received and our consultation with our own external experts, we issued letters in September 2016 to reconfirm our key concerns and outlined our position on the accounting treatment of the pension assets in an effort to encourage constructive dialogue and to receive an OPCD documented position on this accounting issue.

It was clear, based on the evidence provided and reviewed, that we would issue a qualified audit opinion if an adjustment was not made to recognize a full valuation allowance against the pension assets to reflect that the government cannot presently realize any benefit, i.e., essentially recognizing that the value of the pension asset is reduced to zero.

3.5 Legislated Accounting for Pension Assets

On September 30, 2016, the government amended the Ontario Regulation 395/11 for the current year's accounting treatment of the pension assets to mandate that a full valuation allowance be taken against the recorded pension assets. This resulted in the pension assets value to the government as at March 31, 2016, being reduced to zero.

Historically, we have reported that it is a troubling precedent for a government to adopt accounting practices through legislation rather than following standards issued by the independent standard setters—the PSAB. Our position remains the same. Complying with generally accepted accounting standards does not require a regulation, and the move to legislate this accounting treatment for the pension assets was unnecessary.

However, the government had conveyed to us that senior management in the Ministry of Finance and Treasury Board Secretariat needed legislation in order to sign the management representation letter. A signed management representation letter is a requirement under Canadian Auditing Standards to indicate the fulfilment of management's responsibilities in an audit. These include and are not limited to ensuring that the financial statements have been prepared in accordance with PSAB standards for provincial government purposes.

Prior to passing the regulation, on September 29, 2016, the government provided us with an updated version of the financial statements with the pension asset adjustment as shown in the now tabled audited consolidated financial statements. A read of the notes to the consolidated financial statements reveals the purpose of the legislation. In Note 18, the government disclosed that the change in accounting was made to reflect our Office's view of PSAB standards as it relates to accounting treatment of the net pension assets.

To be clear, it is the government's responsibility to prepare the financial statements on the basis of the applicable financial reporting framework. In the case of the Province's consolidated financial statements, the applicable framework is legislation and PSAB standards. The onus is on the government to decide the accounting treatments it believes are most appropriate to use in accounting for transactions. If there is a disagreement on the application of the PSAB standards related to a material matter, this results in a qualified audit opinion, as the Auditor General's opinion has to be provided with reference to the PSAB standards.

As the preparer of its own financial statements, the government did not put forward adequate evidence to support its position to continue to recognize the $10.668 billion pension asset under PSAB standards. Instead, it passed legislation that enabled it to publicly disagree with our Office while at the same time avoiding a qualification on the 2015/16 annual deficit and accumulated deficit figures.

The legislation was used as a tool to prescribe an accounting treatment for the government. As we discuss later in our report, the government has and continues to issue selective regulations rather than apply independently established accounting standards.

Notably, however, the regulation did not extend this accounting treatment to the prior comparative fiscal year ended March 31, 2015, and this ultimately served as the basis for the Auditor General's qualified opinion because the same error in the comparative information should have been corrected under PSAB standards. We communicated this concern the day after we received the September 29, 2016, version of the March 31, 2016, consolidated financial statements.

3.6 Release of Unaudited Financial Statements

Our Office was disappointed that the government decided to release the consolidated financial statements without the Auditor General's audit opinion on October 3, 2016. On the morning of October 3, 2016, prior to the release of the consolidated financial statements, we were still in discussions with management about the pension asset issue (its presentation in the statements and the related note disclosures) following receipt of the September 29, 2016, version (the updated draft of the consolidated financial statements). We had met that morning with the Minister of Finance, the Minister responsible for Treasury Board, their Deputy Ministers and their Chiefs of Staff, and left the meeting with the impression they would get back to us with amended draft statements.

In its news release, the government maintained that the unaudited financial statements were released to ensure openness and transparency, yet the manner in which this was done had taken our Office by surprise. Despite meeting earlier in the day to discuss the financial statements, there was no indication from the government that it planned to release these statements later that day. In fact, the Chief of Staff of the Minister of Treasury Board Secretariat notified the Auditor General in an email of the decision to release the statements, only 50 minutes before their technical briefing to the media.

This is the first time that unaudited consolidated financial statements for the province of Ontario have been released.

While it was disappointing that the government took this unprecedented step, at the same time it also provided resolution to the ongoing pension asset issue as the government then affirmed that the released unaudited financial statements were to be the final consolidated financial statements and no further changes were to be expected. On this note and upon receipt of the signed management representation letter, the Auditor General was then able to provide her opinion on October 5, 2016.

3.7 Basis for Qualified Opinion

Although the government correctly adjusted this year's deficit to include a $1.514 billion increase to pension expense and an increase of $10.668 billion to the pension liabilities, it did not process this adjustment correctly because it did not make the same adjustment for the same error that existed in the prior year comparative period.

The restatement of the comparative period is required under PSAB standards because the prior period adjustment is significant enough that it could affect decisions made by users of the Province's consolidated financial statements. Of further concern is that, by not restating, the government demonstrates a lack of transparency on the nature of the adjustment of the pension assets as a correction of an error in prior periods.

PSAB standards state that "the nature of the government requires a degree of transparency in financial reporting that most private sectors do not offer. The level of understanding of government finances held by most financial statement users demands this greater transparency. Governments are accountable to taxpayers on many levels, in contrast to the more limited accountability a company has for return on investment to a limited group of investors." With these reasons in mind, the lack of the restatement of the 2015 comparative period has resulted as the basis for the qualified audit opinion.

3.8 Other Matter Paragraph

Consistent with prior years, the audited consolidated financial statements and the auditor's report are included in the Public Accounts Annual Report (Annual Report), which also consists of the financial statement discussion and analysis (FSD&A). The FSD&A provides a high-level summary of the fiscal year's results, including analysis of the significant variances between the current fiscal year's actual results and the previous fiscal year's budget and actual results, as well as significant financial trends.

In accordance with Canadian Auditing Standards, our Office has the responsibility to read the Annual Report to ensure that the integrity of the audited consolidated financial statements are not undermined by contradictory information in other annual report sections, such as the FSD&A.

The Other Matter paragraph draws attention to the fact that the comparative periods disclosed in the FSD&A also have not been restated for the pension asset accounting prior period adjustment. Given the materiality of the amounts related to prior periods, the discussion and analysis of the fiscal year's results would, if the amounts were restated, be materially different from the current version.

3.9 Discussion of the Accounting Treatment of a Pension Asset

A pension asset generally arises when the government's total contributions to a plan (plus interest earned thereon) is greater than the pension expense recognized for employee service since the plan's inception.

In addition, PSAB standards limit the carrying amount of the pension asset. The limit requires a government to record a valuation allowance for any excess of the pension asset over the government's "expected future benefit." In other words, the limit calculation caps the pension asset at an amount equal to the government's expected future benefit. Subsequent changes in a valuation allowance are recorded in the consolidated statement of operations in the period that the change occurs.

As shown in Note 6 to the consolidated financial statements, the Province recorded a valuation allowance against the total amount of pension assets related to OTPP and OPSEU as at March 31, 2016. Essentially, the expected future benefit of the pension assets was determined to be zero.

A government's expected future benefit is the benefit a government expects to realize from a pension plan's surplus. The benefit can be in the form of reductions in future required contributions or cash withdrawal of the surplus.

PSAB standards provide guidance on the factors to consider in determining whether a benefit should be included in the calculation of a government's expected future benefit. For example, expected future benefit excludes any surplus withdrawals to which the government is not currently entitled, such as those subject to the approval of employees, an appropriate regulatory authority, or a court of law, where no such approval has been granted.

The standards specifically state that a government may not *anticipate* obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. The same concepts are applicable when determining the government's ability to reduce its future minimum contributions.

After reviewing the agreements governing the jointly sponsored pension plans, we determined that the government does not have the unilateral right to reduce contributions without reaching a formal agreement with the plans' joint sponsors. As a result, we concluded that the government did not have a legally enforceable right to benefit from the pension assets because agreement from the joint sponsors was not obtained for either the current or prior fiscal year.

For greater certainty, we also examined whether the pension assets met the definition of an asset laid out in the financial statement concepts that underpin all PSAB standards. This guidance defines assets as economic resources controlled by a government as a result of past transactions or events, and from which it expects to obtain future economic benefits. The three essential characteristics of assets are:

- They must embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.
- The government can control the economic resource and access to the future economic benefits.
- The transaction or event giving rise to the government's control has already occurred.

The first characteristic could potentially be met as the asset offers the potential for either reduced future cash inflow or reduced cash outflows in the form of a surplus withdrawal or a reduction in future contributions. A further option is that benefits could be increased to members.

However, the second characteristic is not met because the government does not control access to the benefits of the plan surplus, including taking any unilateral actions to change its contribution amounts, taking contribution holidays, or withdrawing surplus. Under both plan agreements, these actions require negotiation and agreement between the two joint sponsors. No transaction or event has occurred to give the government this legally enforceable right and, as a result, the government has neither control, nor access to the assets. As a result, the third characteristic also is not met. Therefore, we could not conclude that the pension assets reported by the Province met the definition of an asset as at March 31, 2016 or in prior years.

The result of applying PSAB standards is an adjustment to recognize a valuation allowance against the total amount of pension assets to reflect an expected future benefit of zero. This is also consistent with the application of the fundamental concepts in the standards on recognition of assets.

Our position that a full valuation allowance against a reported pension asset should be recognized is consistent with the application of PSAB standards used by both British Columbia and New Brunswick in preparing their consolidated financial statements.

RECOMMENDATION 1

We recommend that the Treasury Board Secretariat and the Ministry of Finance finalize their position on the pension asset issue.

RESPONSE FROM TREASURY BOARD SECRETARIAT IN CONJUNCTION WITH MINISTRY OF FINANCE

To inform the Province's accounting treatment for pension plans, the government has established an Expert Advisory Panel (Panel) that will provide advice on the interpretation of Public Sector Accounting Standards (PSAS) to the Province's net pension assets.

The Panel's recommendations will inform the Province's final position paper on accounting for net pension assets, which will be shared with the Office of the Auditor General.

3.10 Office of the Provincial Controller Division

The Office of the Provincial Controller Division (OPCD) plays an essential role in the preparation of the Province's consolidated financial statements. It also ensures effective financial management, accounting and control of programs, activities and resources by providing timely accurate advice. This includes providing accounting and financial advice to ministries, working with the Office of the Auditor General and alerting senior officials to significant issues.

With accounting standards changes and the need to account for new and increasingly complex transactions that need to be reflected in the consolidated financial statements, this invariably creates significant workload pressures for OPCD staff. As well, staffing changes add to the challenges faced by OPCD.

Despite these pressures, it is important for our audit that OPCD has the capacity to adequately address accounting issues on a timely basis as they arise. This includes the timely preparation of position papers on these issues to support both the preparation and audit of the consolidated financial statements.

RECOMMENDATION 2

In order to ensure that appropriate, timely and complete information is provided to the Office of the Auditor General during the conduct of the audit of the consolidated financial statements for the Province of Ontario, the Office of the Provincial Controller Division should:

- proactively alert senior officials in the Treasury Board Secretariat and the Ministry of Finance to significant issues that arise during the course of the annual audit;
- provide the Office of the Auditor General with complete and timely position papers on significant accounting issues that detail its accounting positions and support for those positions; and
- strengthen and increase internal resources dedicated to providing accounting advice and preparing and finalizing the consolidated financial statements.

OFFICE OF THE PROVINCIAL CONTROLLER DIVISION RESPONSE

As part of the audit planning process for the 2016/17 Public Accounts, the Office of the Provincial Controller Division will work with the OAG to ensure a common understanding of all issues.

3.11 Government's Use of External Advisers

The government engages external advisers throughout the year in various capacities that include providing accounting analysis, advice and interpretation. The interests of the Treasury Board Secretariat, the Ministry of Finance and the Office of the Auditor General are best served when there is full disclosure on the intent and use of external advisers. For this reason, any work performed by external advisers in formulating an accounting position should be shared with the Office of the Auditor General as soon as possible, as part of the audit of the consolidated financial statements.

RECOMMENDATION 3

Given that the Office of the Auditor General is the appointed auditor for the consolidated financial statements of the Province of Ontario, and in the interest of ensuring that all information is provided to the Office of the Auditor General on a timely basis, the Treasury Board Secretariat should:

- provide copies of contracts with the expert advisers it uses for accounting advice and opinions in order to ensure that the Office of the Auditor General understands the work that the expert advisers are performing and the impact it has on the annual audit; and
- request that their external advisers, engaged to provide accounting advice and opinions related to the public accounts audit, notify the Office of the Auditor General of the engagement as required by the Code of Professional Conduct of the Chartered Professional Accountants of Ontario.

TREASURY BOARD SECRETARIAT RESPONSE

We will ensure that information required to be provided under professional standards is shared with the Office of the Auditor General.

4.0 Use of Legislated Accounting Standards

PSAB standards are largely accepted by federal, provincial, territorial and local governments as the basis for the preparation of their financial statements.

However, as standards develop to address increasingly complex transactions, especially when the standards have a significant impact on the accounting for and measurement of transactions affecting a government's annual deficit or surplus, or net debt, governments may become more reluctant to adopt them because of the potential to create volatility in annual results.

As discussed in our *2015 Annual Report*, the government passed legislation in 2009/10, 2011 and 2012 giving it the ability to make regulations for specific accounting treatments rather than apply independently established accounting standards. Ontario has passed legislation or amended regulations to enable it to prescribe accounting policies for its public-sector entities as follows:

- The *Investing in Ontario Act, 2008* (Act) and related regulations allows for the government to provide additional transfers to eligible recipients from unplanned surpluses reported in its consolidated financial statements. Any transfers made under the Act would be recorded as an expense of the government for that fiscal year, regardless of PSAB accounting standards.

- In the 2009/10 fiscal year, the *Education Act* and the *Financial Administration Act* were amended. The *Education Act* amendments specified that the government could prescribe accounting standards for Ontario School Boards to use in preparing financial statements. The *Financial Administration Act* amendments allow the government to prescribe accounting standards for any public or non-public entity whose financial statements are included in the province's consolidated financial statements.
- In 2011, a regulation under the *Financial Administration Act* directed Hydro One, at the time wholly owned by the Ontario government, to prepare its financial statements in accordance with U.S. generally accepted accounting principles, effective January 1, 2012. The government then told another wholly owned government business enterprise, Ontario Power Generation Inc. (OPG), to do the same. American accounting rules allow rate-regulated entities to defer current expenses for recognition in future years; the government's direction to adopt these U.S. rules came in anticipation of the planned Canadian adoption of International Financial Reporting Standards (IFRSs), which at the time did not allow for such deferrals.
- Ontario government regulations now require transfers for capital acquisitions and transfers of tangible capital assets to be accounted for by controlled transfer recipients as deferred contributions. The deferred amounts are to be brought into revenue by transfer recipients at the same rate as they recognize amortization expense on the related assets. We have supported this accounting because we believe that it best reflects the economic reality of the underlying transactions and complies with generally accepted accounting principles. PSAB standards in this area are being interpreted differently by many stakeholders.
- The 2012 budget further amended the *Financial Administration Act* to provide the government with full authority to make regulations regarding the accounting policies and practices used to prepare its consolidated financial statements.

We have raised this issue of the risk of the government's potential use of legislated accounting treatment on a number of occasions in our previous Annual Reports. It is critical that Ontario continue to prepare its financial statements in accordance with generally accepted accounting standards, specifically those of PSAB, in order to maintain its financial reporting credibility.

As the auditor of these statements, the Auditor General is required to opine on "whether the consolidated financial statements of Ontario, as reported in the Public Accounts, present fairly information in accordance with appropriate generally accepted accounting principles (GAAP)." If the government reported a deficit or surplus under legislated accounting standards that was materially different than what it would be under GAAP, the Auditor General would have no choice but to include a reservation in the audit opinion, as was done this year.

We have reported in the past that legislated accounting treatments have not yet resulted in the province's consolidated financial statements materially departing from PSAB standards.

RECOMMENDATION 4

We recommend the government follow the accounting standards established by PSAB, rather than using legislation and regulations to prescribe accounting treatments.

TREASURY BOARD SECRETARIAT RESPONSE

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

For the 2015/16 Public Accounts, the government passed a time-limited regulation prescribing the accounting treatment for net pension assets in order to allow Treasury Board Secretariat and Ministry of Finance officials to sign off on Public Accounts.

The recommendations of the Expert Advisory Panel on Pension Assets will help to inform the government's decision on future accounting for pension assets under public sector accounting standards.

5.0 Update on Ontario's Debt Burden

In previous Annual Reports, we have commented on Ontario's growing debt burden, attributable to its large deficits in recent years and its investments in capital assets such as infrastructure, and we do so again this year.

We noted that the Province has relied on historically low interest rates to keep its debt-servicing costs relatively stable, but the debt itself, whether measured as total debt, net debt or accumulated deficit, continues to grow. **Figure 2** shows that the Province's debt levels continue to rise, though at a lower rate than projected last year.

- **Total debt** is the total amount of borrowed money the government owes to external parties. It consists of bonds issued in public capital markets, non-public debt, T-bills and U.S. commercial paper. Total debt provides the broadest measure of a government's debt load.
- **Net debt** is the difference between the government's total liabilities and its financial assets. Liabilities consist of all amounts the government owes to external parties, including total debt, accounts payable, pension and retirement obligations, and transfer payment obligations. Financial assets are those that theoretically can be used to pay off liabilities or finance future operations, and include cash, accounts receivable, temporary investments and investments in government business enterprises. Net debt provides a measure of the amount of future revenues required to pay for past government transactions and events.
- **Accumulated deficit** represents the sum of all past annual deficits and surpluses of the government. It can also be derived by deducting the value of the government's non-financial assets, such as its tangible capital assets, from its net debt.

5.1 Main Contributors to Net Debt

The Province's growing net debt since the end of the 2008/09 fiscal year is attributable to its large deficits in recent years, along with its investments in capital assets such as buildings, other infrastructure and equipment acquired directly or through public-private partnerships for the government or its consolidated organizations, such as public hospitals, as illustrated in **Figure 3**.

Chapter 2

Figure 2: Total Debt, Net Debt, and Accumulated Deficit, 2010/11–2018/19

Sources of data: March 31, 2016 Province of Ontario Consolidated Financial Statements, 2016 Ontario Budget and Office of the Auditor General of Ontario

	Actual ($ million)						Estimate ($ million)		
	2010/11[1]	2011/12[1]	2012/13[1]	2013/14[1]	2014/15[1]	2015/16[2,3]	2016/17[1,4]	2017/18[1,4]	2018/19[1,4]
Total debt	236,629	257,278	281,065	295,758	314,960	327,413	331,148	336,700	343,200
Net debt[3]	214,511	235,582	252,088	267,190	284,576	305,233	308,315	316,900	326,800
Accumulated deficit	144,573	158,410	167,132	176,634	187,511	202,697	197,753	197,700	197,700

1. 2016 Ontario Budget.
2. 2015/16 Province of Ontario Consolidated Financial Statements.
3. 2015/16 Net debt includes a $10.7-billion adjustment made to record a pension-asset valuation allowance.
4. Amounts have not been adjusted for the effects of the pension adjustment made in 2015/16.

While annual deficits are projected to decline, the Province is still increasing its annual borrowings to finance these deficits, replace maturing debt and to fund infrastructure. In fact, the net debt is projected to continue to grow in absolute terms even after the Province starts to run annual budget surpluses. The Province can begin paying down its debt only when such future surpluses provide cash flows over and above the amounts required to fund government operations plus its net investments in tangible capital assets.

By the time the government projects it will achieve a surplus in 2017/18, Ontario's net debt will have almost doubled over a 10-year period, from $169.6 billion in 2008/09 to over $326.8 billion by 2018/19. We estimate total debt will exceed $343.2 billion by 2018/19.

To put this in perspective, the amount of net debt owed by each resident of Ontario on behalf of the government will increase from about $12,000 per person in 2008 to about $23,400 per person in 2019. In other words, it would cost every Ontarian $23,400 to eliminate the Province's net debt.

5.2 Ontario's Ratio of Net Debt to GDP

We noted a key indicator of the government's ability to carry its debt is the level of debt relative to the size of the economy. This ratio of net debt to the market value of goods and services produced by an economy (the gross domestic product, or GDP) measures the relationship between a government's obligations and its capacity to raise the funds needed to meet them. It is an indicator of the burden of government debt on the economy.

If the amount of debt that must be repaid relative to the value of the GDP is rising—in other words, the ratio is rising—it means the government's net debt is growing faster than the provincial economy, and becoming an increasing burden.

Figure 3: Net Debt Growth Factors, 2009/10–2018/19

Sources of data: March 31, 2016 Province of Ontario Consolidated Financial Statements, 2016 Ontario Budget and Office of the Auditor General of Ontario

	Net Debt Beginning of Year ($ million)	Deficit/ (Surplus) ($ million)	Net Investment in Tangible Capital Assets[1] ($ million)	Miscellaneous Adjustments[2] ($ million)	Net Debt End of Year ($ million)	Increase/ (Decrease) ($ million)
Actual						
2009/10	169,585	19,262	5,832	(1,090)	193,589	24,004
2010/11	193,589	14,011	7,306	(395)	214,511	20,922
2011/12	214,511	12,969	7,234	868	235,582	21,071
2012/13	235,582	9,220	7,784	(498)	252,088	16,506
2013/14	252,088	10,453	5,600	(951)	267,190	15,102
2014/15	267,190	10,315	6,509	562	284,576	17,386
2015/16	284,576	5,029	5,471	10,157[3]	305,233	20,657
Estimated						
2016/17[4]	305,233	4,300	11,200	(12,418)	308,315	3,082
2017/18[4]	320,733	–	12,400	(3,770)	316,945	8,630
2018/19[4]	333,133	–	14,200	(4,318)	326,827	9,882
Total over 10 years	**–**	**85,559**	**83,536**	**(11,853)**	**–**	**157,242**

1. Includes investments in government-owned and broader public sector land, buildings, machinery and equipment, and infrastructure assets capitalized during the year less annual amortization and net gains reported on sale of government-owned and broader public sector tangible capital assets.
2. Unrealized Fair Value Losses/(Gains) on the Ontario Nuclear Funds Agreement (ONFA) Funds held by Ontario Power Generation Inc. and accounting changes.
3. In addition to ONFA, the amount includes the impact of 2015/16 accounting treatment of pension assets.
4. Amounts have not been adjusted for the effects of the pension adjustment made in 2015/16.

Figure 4 shows that the Province's net-debt-to-GDP ratio gradually fell over a period of eight years, from a high of 29.3% in 2000/2001 to 26.0% in 2007/08. However, it has been trending upward since then, reflecting factors such as the 2008 global economic downturn, when tax revenues fell abruptly and significant increased borrowing to fund annual deficits and infrastructure stimulus spending.

The net-debt-to-GDP ratio for 2015/16 is 40.9%, which is 1% higher than what was projected for 2015/16 in the prior year. The increase is attributable primarily to the change in accounting treatment of public-sector pension assets reported in the Province's consolidated financial statements. The change increased the 2015/16 pension and other post employment benefits liability by $10.668 billion and increased net debt by the same amount. The pension asset error was unknown to the government at the time it prepared the 2015/16 budget.

The government expects the ratio will begin falling, dropping to 38.9% in 2017/18 and 38.5% in 2018/19. We note a small improvement in the projected net-debt-to-GDP ratio from last year's estimates of 39.9% in 2016/17, and 39.3% in 2017/18. However, these projections do not reflect the effects of the annual pension asset adjustment of $1.5 billion made in 2015/16 that may also have to be made in 2016/17, 2017/18 and 2018/19.

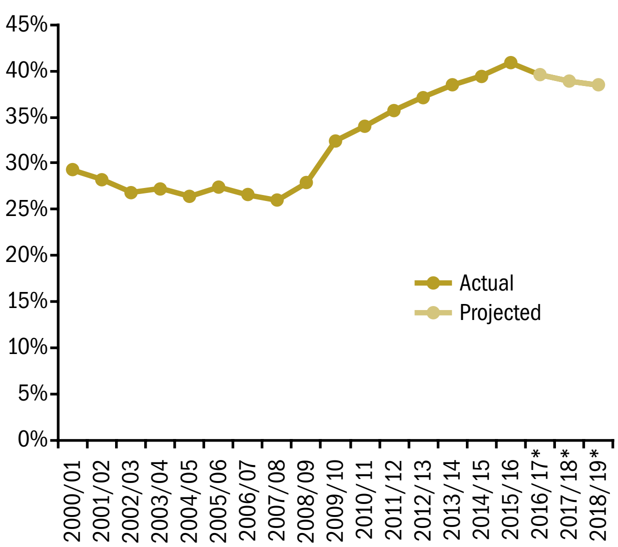
We noted in our 2015 Annual Report that many experts believe when a jurisdiction's net-debt-to-GDP ratio rises above 60%, that jurisdiction's fiscal health is at risk and is vulnerable to unexpected economic shocks.

We also noted it is somewhat of an oversimplification to rely on just one measure to assess a government's borrowing capacity, because that measure does not take into account Ontario's share of federal and municipal debts. If the Province's share of those debts was included in its indebtedness calculations, the net debt would be much higher. However, consistent with debt-measurement methodologies used by most jurisdictions, we have focused throughout our analysis only on the provincial government's own net debt.

Figure 5 shows the net debt of Ontario compared to other provinces and the federal government, along with their respective ratios of net debt

Figure 4: Ratio of Net Debt to Gross Domestic Product (GDP), 2000/01–2018/19

Source of data: March 31, 2015 and March 31, 2016 Province of Ontario Annual Report – Financial Statement Discussion and Analysis



Note: Net debt includes broader-public-sector net debt starting in 2005/06.

* Amounts have not been adjusted for the effects of the pension adjustment made in 2015/16.

Figure 5: Net Debt and the Net-Debt-to-GDP Ratios of Canadian Jurisdictions, 2015/16

Sources of data: Province of Ontario Annual Report and Consolidated Financial Statements; Annual Report and Consolidated Financial Statements of other provincial jurisdictions; Federal Budgets and budget updates, budgets of provincial jurisdictions; and the Office of the Auditor General of Ontario

	Net Debt ($ million)	Net Debt to GDP (%)
AB	(3,881)	(1.22)
SK	7,889	10.3
BC	39,635	16.2
MB	21,433	32.5
Federal	693,800	35.0
PEI	2,183	35.4
NS	15,097	37.9
ON	305,233	40.9
NB	13,660	41.3
NL	12,654	42.7
QC	187,098	49.6

Chapter 2

to GDP. Generally, the western provinces have a significantly lower net-debt-to-GDP ratio than Ontario and the Atlantic provinces, and Quebec has a significantly higher ratio of net-debt-to-GDP than Ontario.

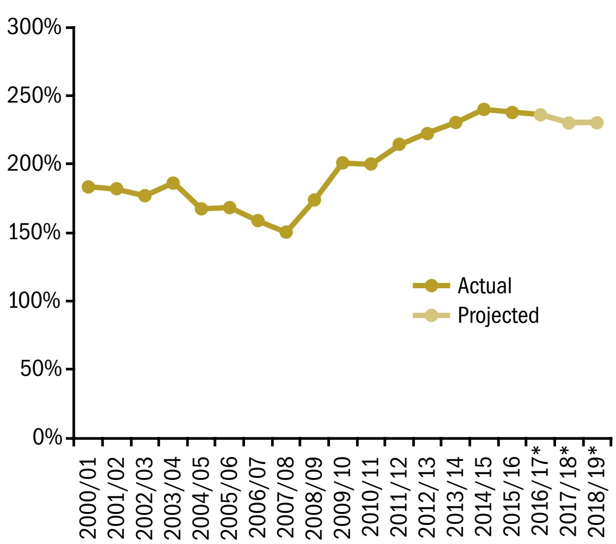
5.3 Ratio of Net Debt to Total Annual Revenue

Another useful measure of government debt is the ratio of net debt to total annual revenues, an indicator of how much time it would take to eliminate the debt if the Province spent all of its revenues on nothing but debt repayment. For instance, a ratio of 250% indicates that it would take 2½ years to eliminate the provincial debt if all revenues were devoted exclusively to it.

As shown in **Figure 6**, this ratio declined from about 183% in 2000/2001 to about 150% in 2007/08, reflecting the fact that, while the Province's net debt remained essentially the same, annual provincial revenue was increasing. However, the ratio has increased steadily since 2007/08 and is expected to top 236% by 2016/17 before beginning to fall. This increasing ratio of net debt to total annual revenue indicates the Province's net debt has less revenue to support it. Again, the 2016/17 projection does not reflect the pension asset adjustment made in 2015/16. The projection going forward with the impact of the pension asset adjustment is unknown.

Figure 6: Ratio of Net Debt as Percentage of Total Annual Revenue, 2000/01–2018/19

Sources of data: March 31, 2016 Province of Ontario Consolidated Financial Statements, 2016, 2015, 2009, 2008 Ontario Budgets, Office of the Auditor General of Ontario



* Amounts have not been adjusted for the effects of the pension adjustment made in 2015/16.

5.4 Ratio of Interest Expense to Revenue

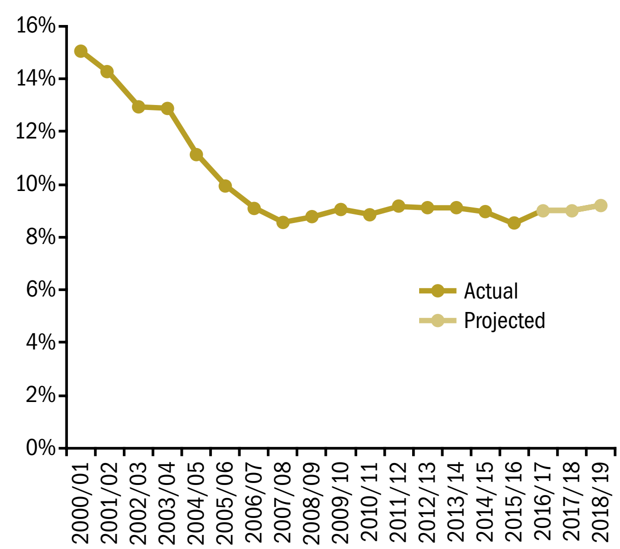
Increases in the cost of servicing total debt, or interest expense, can directly affect the quantity and quality of programs and services that government can provide: the higher the proportion of government revenues going to pay interest costs on past borrowings, the lower the proportion available for spending in other areas.

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

As **Figure 7** shows, the Province's interest-expense-to-total-revenues ratio decreased steadily in the decade ending in 2007/08, due mainly to lower interest rates. Because rates have been at his-

Figure 7: Ratio of Interest Expense to Revenue, 2000/01–2018/19

Sources of data: March 31, 2016 Province of Ontario Consolidated Financial Statements, 2015, 2009, 2008 Ontario Budgets, Office of the Auditor General of Ontario



toric lows since the beginning of this decade, both the actual and projected interest-expense-to-total revenues ratio have held, and are expected to hold steady, at around 9.0% from 2009/10 to 2018/19, even as the Province's total borrowings are expected to increase by approximately $131.0 billion, or 62%, from $212 billion to over $343 billion over this same time period. This means that 9 cents of every dollar in revenue that the government collects will go towards paying interest on debt. Based on the government's latest projections, the ratio is expected to gradually increase to 9.2% by 2018/19, when total debt is expected to be around $343 billion.

The province's debt also exposes it to further risks, the most significant being interest-rate risk. As noted above, interest rates are currently at record low levels, enabling the government to keep its annual interest expense relatively steady even as its total borrowing has increased significantly. However, if interest rates rise, the government will have considerably less flexibility to provide public services because a higher proportion of its revenues will be required to pay interest on the province's outstanding debt. As was noted in last year's *Annual Report*, the government has mitigated its interest-rate risk to some extent by increasing the weighted average term of its annual borrowings in order to take advantage of the current low rates.

The ratio of interest-expense-to-revenue is expected to increase marginally beginning in 2018/19, indicating the government will have less flexibility to respond to changing economic circumstances. Past government borrowing decisions mean a growing portion of revenues will not be available for other current and future government programs.

5.5 Consequences of High Indebtedness

Our commentary last year highlighted the consequences for the Province of carrying a large debt load—and the same observations are relevant this year. They include the following:

- **Debt-servicing costs cut into funding for other programs:** As debt grows, so do interest costs. As interest costs consume a greater proportion of government resources, there is less to spend on other things. To put this "crowding-out" effect into perspective, the government currently spends more on debt interest than on post-secondary education.
- **Greater vulnerability to interest-rate increases:** Ontario has been able to keep its annual interest expense relatively steady, even as its total borrowing has increased significantly. For example, it was paying an average effective interest rate of about 8.4% in 1999/2000, but that dropped to 3.6% in 2015/16. However, if interest rates start to rise again, the government will have considerably less flexibility to provide public services as it will have to devote a higher proportion of its revenue to interest.
- **Potential credit-rating downgrades could lead to higher borrowing costs:** Prepared by specialized agencies, credit ratings assess a government's creditworthiness largely based on its capacity to generate revenue to service its debt. They consider such factors as a government's economic resources and prospects, industrial and institutional strengths, financial health, and susceptibility to major risks. A credit rating affects the cost of future government borrowing, with a lower rating indicating that an agency believes there is a relatively higher risk that a government will default on its debt. Accordingly, investors will lend to that government only in return for a greater risk premium, in the form of higher interest rates. A rating downgrade could also shrink the potential market for a government's debt, because some investors will not hold debt below a certain rating.

5.6 Final Thoughts

We recognize that, ultimately, decisions about how much debt the Province should carry, and the strategies to pay down that debt, are questions of government policy. However, as we observed last year, this should not prevent the government from providing information to promote a greater understanding of the issue and clarify the choices it is making, or will make, to address it.

We continue to believe that in light of the government's plan to eliminate its annual deficit by 2017/18, and given that its debt-carrying costs are expected to rise from their current historic lows, this would be a good time for the government, legislators and the public to continue to keep an eye on the level of debt on Ontario and the relationship of net debt to GDP.

While annual deficits are projected to decline, the Province continues to increase its borrowings annually to finance these deficits, replace maturing debt and fund infrastructure. In fact, the net debt is projected to continue growing in absolute terms even after the Province starts to run annual budget surpluses. The Province can begin paying down its debt only when such future surpluses provide cash flows over and above the amounts required to fund government operations and its net investments in tangible capital assets.

We noted that government debt has been described as a burden on future generations, especially debt used to finance operating deficits (debt used to finance infrastructure is more likely to leave behind tangible capital assets that benefit future generations). The government has presented a plan to eliminate its annual deficit in 2017/18 by restraining spending, and committed to subsequently reducing the net-debt-to-GDP ratio to the pre-recession level of 27%. Although the strategy that has been articulated is one where infrastructure spending will be used to spur the economy and increase GDP, thereby reducing the net-debt-to-GDP ratio (discussed in **Chapter 3** of our December 2015 Report titled *The Economic Development and Employment Program*) there is still a need to project the reduction of the net-debt-to-GDP ratio in the future, taking into account the impact of both infrastructure spending and economic development programs. However, there is no discussion yet around the paying down of debt.

Regardless of what strategy is being contemplated, we believe the government should provide legislators and the public with long-term targets for its plans to address current and projected debt. Therefore, we are reiterating our recommendation from last year.

RECOMMENDATION 5

In order to address the Province's growing total debt burden, the government should work toward the development of a long-term total-debt reduction plan that is linked to its target of reducing its net debt-to-GDP ratio to its pre-recession level of 27%.

TREASURY BOARD SECRETARIAT RESPONSE

The government plans to invest about $160 billion in capital over 12 years that will, in addition to addressing much needed infrastructure requirements, improve the economic growth of the Province. A September 2015 report by the Centre for Spatial Economics found that, on average, investing $1 in public infrastructure in Canada raises GDP by $1.43 in the short term and up to $3.83 in the long term.

Once balance is achieved in 2017/18, increases to net debt will be limited to the difference between the cash investment to build the assets and the amortization which is a non-cash amount. The balanced budget and the government's continued focus on capital investment will add to economic growth, resulting in GDP growing more quickly than debt, and lowering the net debt-to-GDP ratio to the government's 27% target.

6.0 Significant Accounting and Reporting Issues

6.1 Consolidation of Hydro One and Ontario Power Generation

PSAB standards direct government business enterprises (GBEs) to follow the accounting rules applicable to publicly accountable enterprises and prepare their financial statements using International Financial Reporting Standards (IFRS) effective for the fiscal year beginning on or after January 1, 2011. IFRS is the Canadian generally accepted accounting principles applicable to these enterprises.

Three of the five GBEs that are consolidated by the Province report financial results under IFRS as required by PSAB standards (i.e., Brampton Distribution Holdco Inc, Liquor Control Board of Ontario and Ontario Lottery and Gaming Corporation). The other two GBEs, Hydro One and Ontario Power Generation (OPG), do not report under Canadian generally accepted accounting principles (i.e., IFRS) and instead have used U.S. generally accepted accounting principles (U.S. GAAP) since 2012.

The transition to U.S. GAAP was brought about by the Ontario Regulation 395/11 which the government passed in response to the decision made by the Chartered Professional Accountants of Canada (formerly the Canadian Institute of Chartered Accountants) Accounting Standards Board (AcSB) to adopt IFRS for all publicly accountable enterprises. At the time, U.S. GAAP had provisions to cover the accounting by corporations whose rates are regulated by an independent, third party regulator, but IFRS did not. The use of rate regulated accounting is under review by both the AcSB and the International Accounting Standards Board (IASB). Rate regulated accounting is discussed in further detail later in this report.

The AcSB had issued multiple extensions to rate-regulated organizations to allow them to continue to use the "pre-changeover accounting standards" (i.e., former Canadian GAAP prior to adoption of IFRS) that included provisions for rate-regulated accounting up to January 1, 2015.

Since 2012/13, even though Hydro One and OPG have been using U.S. GAAP for their stand-alone financial statements, these financial statements have been converted to the former Canadian GAAP for inclusion in the Province's consolidated financial statements.

In January 2014, the IASB issued an interim IFRS standard that permits first-time adopters of IFRS to continue their previous GAAP accounting for regulatory deferral account balances, with limited presentation changes. This interim IFRS standard was effective for annual periods beginning on or after January 1, 2015.

Hydro One and OPG both have December 31 fiscal year-ends. The Province's accounting policy is to adopt in-year accounting policy changes to the next full provincial fiscal year. As such, the Province continued to consolidate Hydro One and OPG in the 2014/15 fiscal year based on the results under the former Canadian GAAP.

We examined the differences between IFRS and the former Canadian GAAP at the time and concluded that the estimated differences had no material effect on the annual deficit.

Recognizing that the government was choosing to continue to use U.S. GAAP and not IFRS for consolidation of the financial results of OPG and Hydro One in the Province's consolidated financial statements, we requested and received from OPG and Hydro One's attest auditors, through specified procedures, the differences for 2015/16 between U.S. GAAP and IFRS. We relied on their work for consolidation purposes.

In February 2016, the Treasury Board Secretariat wrote CPA Canada's Accounting Oversight Committee and PSAB requesting that the PSAB standards recognize U.S. GAAP as a basis of reporting by publicly accountable enterprises because the current standards only refer to IFRS. The government noted that by excluding reference to other sources of GAAP, PSAB mandates that GBE results must be reflected on an IFRS basis. The government expressed concern that this could result in materially different and inconsistent results in the Province's consolidated financial statements than if the rate regulated entities (Hydro One and OPG) results were consolidated on a U.S. GAAP basis. PSAB responded in July 2016 that the PSAB standards would not be changed and all GBEs should prepare their financial statements in accordance with IFRS and not U.S. GAAP.

Despite the response, with the former Canadian GAAP no longer being an option, the government chose to consolidate Hydro One and OPG results under U.S. GAAP in 2015/16 as opposed to consolidating them on an IFRS basis, as required under PSAB standards. We examined the differences between IFRS and U.S. GAAP accounting standards, highlighted by Hydro One and OPG attest auditors, and concluded that these estimated differences had no material effect on the annual deficit. We recorded these differences on our summary of unadjusted audit differences. In addition, we requested that the Province disclose these differences. It disclosed this information in Note 12 to its Consolidated Financial Statements.

We will continue to track these differences in subsequent audits until the government adopts IFRS for the purposes of consolidating the results of OPG and Hydro One, as required. Given the differences in how certain balances are treated under U.S. GAAP versus IFRS, we anticipate that these differences could become material in future fiscal years, potentially as soon as the 2016-17 fiscal year.

RECOMMENDATION 6

We recommend that the Province of Ontario include Hydro One and OPG financial information in the consolidated financial statements using the IFRS reporting framework as required by PSAB standards.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat will continue to work with the Public Sector Accounting Standards Board and the Office of the Auditor General to ensure that the Province's financial reports support transparency and accountability to the public and other users.

6.2 Contaminated Sites

A new PSAB standard came into effect for the fiscal year ending March 31, 2015. It requires the province's liability for contaminated sites to be updated to incorporate any changes that have occurred during each fiscal year.

Examples of changes that would affect the liability estimate include:

- identification of new sites where contamination may exist and assessment, remediation and monitoring may be required;
- additional remediation work performed on existing sites; or
- new information that becomes available about a site following more in-depth assessments or the advent of new technology.

As part of our Public Accounts audit for fiscal year ending March 31, 2016, we examined the liability for contaminated sites and the changes that occurred throughout the fiscal year. The liability balance as at March 31, 2015, was $1.792 billion, which decreased to $1.751 billion as at March 31, 2016. Although there were some new accruals added, the majority of the change is due to amounts spent to remediate sites, which lowered the liability.

We also reviewed sites that were not included in the estimate to ensure the criteria for recognition and disclosure under the PSAB standard were appropriately assessed. We agreed with the relevant ministries' conclusion for not including these specific sites since the PSAB criteria were not met. The ministries will monitor these sites for any changes in the future that may have an effect on the liability for contaminated sites.

For the fiscal year ending March 31, 2016, we are satisfied with the completeness of the ministries' efforts to identify all high-risk sites and to provide a reasonable estimate of the liability reported under PSAB standards.

RECOMMENDATION 7

To ensure that the Province's ongoing contaminated sites liability is reasonably and consistently calculated, the Office of the Provincial Controller Division should continue to work with the ministries to ensure that the Public Sector Accounting Board standards continue to be applied effectively in accounting and measuring these liabilities.

OFFICE OF THE PROVINCIAL CONTROLLER DIVISION RESPONSE

We are pleased that the Auditor General was satisfied with the completeness of the ministries' efforts to identify all high-risk sites and to provide a reasonable estimate of the liability reported under PSAB standards. Treasury Board Secretariat will continue to work with line ministries to support effective reporting in accordance with public sector accounting standards.

6.3 Financial Statement Presentation and Disclosure

Financial-statement presentation disclosures (disclosures) are integral to the financial statements, helping to clarify or further explain items in the statements. PSAB standards stipulate that, when applicable, disclosures be provided under the specific accounting items.

Our Office performed a refresh review of Ontario's disclosures to assess whether further improvements were needed. We used the Province's 2014/15 Consolidated Financial Statements as the basis for our analysis, and undertook a jurisdictional review of Canada's senior governments' financial statements to support our analysis.

Our review concluded that while the disclosures used to prepare the consolidated financial statements conformed in almost all cases, there were instances where disclosures can be improved.

The results of our jurisdictional review showed that the application of the disclosure requirements established by PSAB varied in depth and quality. Ontario was more detailed than some of the other provinces in providing disclosures in certain areas, while also having less detailed disclosures in other areas. Areas for improvement were communicated to the Office of the Provincial Controller Department (OPCD) during our 2015/16 audit. For example, there is still room for improvement in pension and revenue disclosures.

We provided OPCD with our jurisdictional analysis of pension reporting by other senior governments, and noted that many provinces have more robust disclosures than Ontario's. Although OPCD expanded its pension disclosures in the 2015/16 consolidated financial statements as a result of our review, there are still areas for further improvement such as disclosures at the plan level (e.g., net obligation and expense) that would be useful for a user.

Our jurisdictional review also noted that Ontario provided fewer detailed disclosures in the notes to the consolidated financial statements for revenue than other provincial jurisdictions. Currently, the note disclosure for the revenue accounting policy is as follows:

> Revenues are recognized in the fiscal year that the events giving rise to the revenues occur and they are earned. Amounts received prior to the end of the year, which relate to revenues that will be earned in a subsequent fiscal year, are deferred and reported as liabilities.

Even though this disclosure is adequate and does not depart from PSAB standards, we believe it is possible to expand on accounting policies regarding revenues. For example, some provincial jurisdictions provide more revenue recognition information on the different types of revenues, such as government transfers and royalties. Also, many provinces provide further disclosure on their tax revenue policies in their financial statements. For example, most provinces disclose revenue recognition for specific tax streams, such as corporate and personal income taxes.

We believe that in order to provide more detailed information to the public and to be consistent with other provincial jurisdictions, the government should consider providing additional revenue accounting policies disclosure.

The C.D. Howe report entitled *The Fiscal Accountability of Canada's Senior Government, 2016* noted that "[a]ccountability and transparency are watchwords for good governance in the early 21st century. And the bar is rising."

Disclosures are integral to the financial statements and are instrumental in providing key information to the users of the financial statements for both accountability and transparency, the report noted. It should be noted that the report assessed the quality of financial information presented by Canada's senior governments, and gave Ontario top presentation marks, just behind two other provinces, for financial reporting practices based on the presentation of certain financial actual and budget results.

We will continue our dialogue with OPCD to extend the current disclosures to enhance accountability and transparency.

RECOMMENDATION 8

To further improve the accountability and transparency of Ontario's Consolidated Financial Statements for users, the Office of the Provincial Controller Division should expand note disclosures in the consolidated financial statements for pensions and revenues.

OFFICE OF THE PROVINCIAL CONTROLLER DIVISION RESPONSE

The Office of the Provincial Controller Division will review this recommendation and work with the Office of the Auditor General in the upcoming year.

6.4 Annual Report Financial Statement Discussion and Analysis

Each year the government provides a Financial Statement Discussion and Analysis (FSD&A) in its annual report to help the public understand the Province's consolidated financial statements.

An FSD&A's objective is to help users of the statements understand the impact of economic conditions and of government decisions on the Province's financial results for the year, and its financial position at year end.

In our *2015 Annual Report*, we recommended the government consider the guidance outlined in the Public Sector Accounting Board's (PSAB) Statements of Recommended Practice (SORP) in preparing the FSD&A for its annual report.

The government implemented the following changes to address our recommendation, which are listed in its introduction to the FSD&A:

- expand the comparison of the current year's results to those of the prior year, and include analysis of the trends over a five-year period as related to several financial items, including an expanded discussion on balance sheet items;
- provide a description of the Province's capital assets, reflecting their importance in service delivery and their impact on the Province's financial condition; and
- include a discussion of key risks that could impact the Province's financial results.

While we acknowledge the government's effort to improve the FSD&A, the government's decision to not restate the prior year comparatives for the pension assets in its consolidated financial statements for 2015/16 is a non-compliance-with-PSAB-standards issue. This concern broadens to the FSD&A as the financial highlights, variance analysis and trend assessments do not reflect financial results in accordance with PSAB standards.

7.0 Significant Other Matters

7.1 Sale of Hydro One Shares and Hydro One Brampton

In June 2015, the government passed the *Building Ontario Up Act, 2015* (Act) to permit the sale of up to 60% ownership of Hydro One. The Act requires the Province to retain at least 40% ownership in the company and restricts other shareholders from individually holding more than 10% of the total equity of Hydro One.

In November 2015, the Province sold approximately 16 per cent of Hydro One's common shares at a price of $20.50 each through an initial public offering (IPO). An accounting gain of $783 million was recorded as a result of the sale of these common shares through the IPO. As of March 31, 2016, the Province owned approximately 84 per cent of Hydro One's common shares. The financial results of Hydro One's operations were consolidated into the Province's financial results based on the Province's proportionate ownership share at year end.

In addition, Hydro One declared and paid an $800-million special dividend to the Province prior to the IPO. The Province subsequently remitted this amount to the Ontario Electricity Financing Corporation (OEFC) to be recorded against outstanding amounts due from the Province relating to cumulative electricity sector dedicated earnings, which are the cumulative combined net income of Hydro One and Ontario Power Generation in excess of the Province's interest cost on its investment in hydro companies dedicated to help retire OEFC's debt balance.

As a 100%-owned provincial Crown corporation, Hydro One was exempt from corporate taxes prior to the IPO. Despite its tax-exempt status, Hydro One was required to make payments in lieu of corporate taxes (PILs) to the Province in accordance with the *Electricity Act, 1998*. However, when the Province sold off more than 10% of Hydro One, this exemption ended, and Hydro One became subject to federal and provincial corporate income taxes.

Immediately before exiting the corporate PILs regime, Hydro One was deemed to have disposed of its assets for PILs/tax purposes at proceeds equal to the fair market value of its assets. Under the *Electricity Act, 1998* as a result of this deemed disposition, Hydro One had to make a one-time PILs payment to the Province, a "departure tax," of $2.6 billion.

The Province made a $2.6-billion capital contribution to Hydro One to facilitate Hydro One's cash payment of the departure tax. This capital contribution increased the book value of the Hydro One common shares held by the Province (100% at that time). The capital contribution was factored into the calculation of the accounting gain recorded by the Province noted above.

The deemed disposition of Hydro One's assets and related payment of the departure tax gave rise to a deferred tax asset that reflects reduced cash taxes payable by Hydro One in future tax periods. The Province's proportionate share of the deferred tax benefit as of March 31, 2016, increased the Province's revenues by $2.4 billion.

Overall, the Province's sale of Hydro One shares generated a one-time reduction to the annual deficit of approximately $3.2 billion, comprised of the Province's $2.4-billion portion of the deferred tax asset benefit and the $0.8-billion accounting gain on the sale of the shares. The departure tax payment did not affect the 2015/16 annual deficit as the additional $2.6 billion in tax revenue recognized by the Province as Other Tax Revenue was offset by an equal reduction in Hydro One's net income of $2.6 billion due to the higher tax expense. Hydro One's net income is consolidated with the Province's financial results under Income from Government Business Enterprises.

In April 2016, subsequent to the fiscal year end, the Province sold approximately 14% more of Hydro One's common shares, at a price of $23.65 each, in a secondary share offering. This sale brought the Province's ownership stake in Hydro One down to approximately 70%. Barring any additional share sales prior to the end of the 2016/17 fiscal year, Hydro One's financial results will be consolidated into the Province's financial results on a proportionate share basis at this 70% level. We will examine the secondary sale of Hydro One shares and the related accounting gain during our 2016/17 audit.

Prior to the IPO, Hydro One transferred all of the outstanding shares of its former subsidiary, Hydro One Brampton, to the Province, the sole shareholder of Hydro One at the time, at their net book value. The plan at the time was to sell the Hydro One Brampton shares separately from the Hydro One IPO.

On March 24, 2016, the government announced a tentative share sale agreement with three municipally-owned local hydro distribution companies for the Province's shares of Hydro One Brampton at a price of $607 million, subject to closing conditions including approval by the Ontario Energy Board. As part of next year's audit of the Public Accounts, we will examine the sale of the shares of Brampton Hydro One and the related accounting gain when the transaction is completed, expected in late 2016.

7.2 Ontario Trillium Trust

The *Trillium Trust Act, 2014* (Act) provides for an account to be maintained in the Public Accounts to track the prescribed amounts of financial benefits to Ontario from the sale of qualifying assets under the Act. The Act also requires the account to record all expenditures made under the Act to support infrastructure investments. A report on the financial activities of the Trillium Trust is included in Volume 1 of the Public Accounts. It should be noted that the Ontario Trillium Trust is not a separate legal trust with its own funds; it is the name of an account within the consolidated revenue fund set up to track transactions in accordance with the *Trillium Trust Act, 2014*.

Volume 1 shows that $1.35 billion was notionally allocated to the Trillium Trust as at March 31, 2016, in relation to the sale and redemption of the Province's shares in General Motors in prior years. Subsequent to year end, in August 2016, the Province filed a regulation allocating an additional $3.2 billion to the Trillium Trust related to the sale of Hydro One common shares in 2015/16.

By creating a separate account to track transit and transportation expenditures, the Province's intention is to match transit and transportation expenditures to the revenues allocated to the same account. In substance, the Trillium Trust is an account established in the Public Accounts to track revenue gains (including non-cash benefits) from the sale of designated assets that the government has restricted in legislation to be matched to certain government infrastructure projects such as investments in roads, bridges and public transit.

Reporting in Volume 1 on the notional amounts credited to the Trillium Trust, and the notional amounts that are deemed spent from this account, is to reflect the government's public reporting of its commitments to use the amounts allocated to the Trillium Trust for infrastructure investments.

While we review Volume 1 as part of our audit of the Public Accounts we have not audited Volume 1. As a result, Volume 1 of the Public Accounts is marked as "Unaudited." However, going forward we will perform a detailed review on the transactions recorded in the Trillium Trust for compliance with the *Trillium Trust Act, 2014*.

7.3 Ontario Greenhouse Gas Reduction Account

Under the *Climate Change Mitigation and Low Carbon Economy Act*, all revenues from Ontario's cap-and-trade program would be deposited in the consolidated revenue fund and the amounts would be recorded in the new Greenhouse Gas Reduction Account.

Similar to the Ontario Trillium Trust, the Greenhouse Gas Reduction Account will allow the government to track and report to the public on its commitments that the spending allocated to different programs will be at least as much as the revenues collected under the cap-and-trade program.

It is anticipated the Province will begin to collect and deposit revenues into the consolidated revenue fund from cap-and-trade auctions in March 2017.

We will audit the receipts and disbursements recorded in the Greenhouse Gas Accounts for compliance with the *Climate Change Mitigation and Low Carbon Economy Act* and regulations during our Public Accounts audit.

7.4 Pension Economic Assumptions

The government is responsible to select appropriate economic assumptions to appropriately determine the pension liability and pension expense. The need to make assumptions in pension accounting is unavoidable.

The discount rate, determined by the government, is one of the key economic assumptions critical to the calculations that determine a sponsor's pension obligation and pension expense. Under PSAB standards, the government has the choice of setting this rate with reference to expected pension-plan asset returns or to the government's cost of borrowing (i.e., its long-term bond rate). Ontario has chosen to set the discount rate equal to the expected long-term plan asset returns. We discuss the basics of pension accounting further in **Chapter 4**, **Section 4.01** of this Annual Report.

On an annual basis, we evaluate the key pension economic assumptions, including the discount rate, inflation rate and salary-escalation rate. This year, we engaged an external expert adviser to assist us in reviewing these key economic assumptions. Based on the work we have performed this year, we were generally satisfied that these rates were reasonable. However, we have noted that in the 2015/16 fiscal year, the discount rates are edging towards the high end of a reasonable range.

RECOMMENDATION 9

We recommend that the Treasury Board Secretariat and the Ministry of Finance benchmark and review the 2016/17 pension economic assumptions for reasonableness.

RESPONSE FROM TREASURY BOARD SECRETARIAT IN CONJUNCTION WITH MINISTRY OF FINANCE

The 2016/17 pension economic assumptions will be reviewed as part of the process for setting the assumptions for 2017/18. Assumptions from prior years are reviewed based on long-term trends, actual experience and future expectations over the previous year. Decisions are made at that time whether any changes are warranted.

8.0 Financial Reporting Frameworks and Canadian Auditing Standards

The Canadian Auditing Standards (CASs) provide a number of different acceptable frameworks for the preparation of financial statements. As described in **Figure 8**, a financial reporting framework may be general purpose or special purpose, and reflect either a fair presentation or a compliance presentation.

The standards do not specify a particular framework as being acceptable for general-purpose financial statements. Acceptable reporting frameworks include not only financial reporting standards of an established standard-setting organization such as the Public Sector Accounting Board (PSAB) or the Accounting Standards Board (AcSB) of CPA Canada, but also accounting standards established by law or regulation, or standards established by industry organizations.

As we noted in our *2013 Annual Report*, the expansion in acceptable reporting frameworks under CASs would provide governments with a mechanism for establishing accounting policies that could result in financial statements that were not fairly presented. For example, in preparing their

Figure 8: Financial Reporting Frameworks Under Canadian Auditing Standards

Source of data: CPA Canada Auditing and Assurance Standards Board

	General Purpose	Special Purpose
Fair presentation	• Meets the common needs of a wide range of users • Complies with an accounting framework (GAAP—full compliance with PSAB)	• Meets the needs of specific users • Complies with a special-purpose framework (GAAP or non-GAAP) • Explicit deviation from an accounting framework to achieve fair presentation of financial statements
Compliance presentation	• Meets the common needs of a wide range of users • Complies with a non-GAAP accounting framework (i.e., requirements of legislation and/or regulation)	• Meets the needs of specific users • Complies with a special-purpose framework (i.e., internal guideline)

general-purpose financial statements, the Province and its public-sector entities could follow legislated accounting policies that were not in accordance with generally accepted accounting standards, and still obtain an independent auditor's report without reservations.

Generally, if a financial reporting framework established by a law or regulation does not materially differ from the results produced by the standards established by an independent standard-setting organization, then that framework will not affect the independent auditor's fair presentation report on the financial statements prepared under that framework. However, if the legislated financial reporting framework departs from generally accepted accounting standards, a number of issues arise. We believe users of government and public-sector-entity financial statements need to be aware of these issues.

Until the 2010/11 fiscal year, all public-sector entities in Ontario used a reporting framework that was in accordance with PSAB standards.

However, Ontario's 72 school boards now prepare their financial statements using a legislative accounting framework rather than that of PSAB standards, and receive an auditor's report indicating whether the statements comply with the legislated framework. There is no longer a statement in the auditor's report that the financial statements are "fairly presented."

Two of Ontario's electricity-sector entities, Hydro One and OPG, prepare their financial statements under legislation that requires them to use U.S. generally accepted accounting principles rather than Canadian generally accepted accounting principles (i.e. IFRS) as required by PSAB standards. Their auditors provided them with an auditor's report without reservation, as allowed under Canadian Auditing Standards.

To date, these departures from PSAB and CPA Canada AcSB standards for preparing Ontario public-sector-entity financial statements have not had a material impact on the Province's deficit, its net debt or its accumulated deficit. Accordingly, they have not affected our report on the Province's consolidated financial statements.

However, users of public-sector financial statements may not even realize when public-sector entities are not complying with PSAB standards, because audit reporting standards do not require this to be specifically disclosed. Instead, users must now carefully review the wording of auditor's reports and examine the notes to any public-sector entity financial statements to understand the accounting basis on which the financial statements have been prepared.

We believe that accounting standards recommended by Canadian independent standard-setters should form the basis for the preparation not only of the Province's consolidated financial statements, but the financial statements of all other public-sector organizations. Financial statements prepared on such a basis are credible, consistent and comparable, enhancing their usefulness. Allowing preparers to choose to adopt their own accounting standards could undermine these attributes. It could also negatively affect the transparency, credibility and, accordingly, the usefulness of the resulting financial statements.

For that reason, most Canadian governments use PSAB standards in preparing their annual budgets, printed estimates, economic updates and year-end consolidated financial statements. When governments use the same set of accounting standards to prepare key financial reports, the public can evaluate expected financial performance against actual results and against the results of other jurisdictions. PSAB standards are intended to help governments publicly demonstrate stewardship over the resources they manage, and thereby strengthen accountability to taxpayers.

9.0 Update on WSIB

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation created by the *Workplace Safety and Insurance Act, 1997* (Act). Its primary purpose is to provide income support and medical assistance to workers injured on the job. The WSIB receives no funding from government; it is financed through premiums on employer payrolls.

Over the past decade, we raised a number of concerns about significant growth in the WSIB's unfunded liability, which is the difference between the value of the WSIB's assets and its estimated financial obligations to pay benefits to injured workers. Our 2009 Annual Report discussed the risk that the growth and magnitude of the unfunded liability posed to the WSIB's financial viability, including the ultimate risk of the WSIB being unable to meet its existing and future commitments to provide worker benefits.

We also urged the government to reconsider the exclusion of the WSIB's financial results from the Province's consolidated financial statements, particularly if there were any risks that the Province might have to provide funding to ensure the WSIB remained viable. The government excludes WSIB's financial results because it is classified as a "trust;" however, given the WSIB's significant unfunded liability and various other factors, we questioned whether the WSIB operates like a true trust. Including the WSIB in the government's consolidated financial statements would have a significant impact on the government's fiscal performance.

As of June 30, 2010, the WSIB's unfunded liability had grown to almost $13 billion. In September 2010, the WSIB announced an independent funding review to obtain advice on how to best ensure the long-term financial viability of Ontario's workplace safety and insurance system. The May 2012 report contained a number of recommendations, in particular calling for a new funding strategy for the WSIB with the following key elements:

- realistic assumptions, including a discount rate based on the best actuarial advice;
- moving the WSIB as quickly as feasible beyond a "tipping point" of a 60% funding Sufficiency Ratio (a tipping point is a crisis in which the WSIB could not generate sufficient funds to pay workers' benefits within a reasonable time frame and by reasonable measures); and
- putting the WSIB on course to achieve a 90%–110% funding Sufficiency Ratio within 20 years.

In response to our concerns and to the recommendations of the report, the government passed Regulation 141/12 under the Act in June 2012. Effective January 1, 2013, it required the WSIB to ensure it meets the following funding Sufficiency Ratios by specified dates:

- 60% on or before December 31, 2017;
- 80% on or before December 31, 2022; and
- 100% on or before December 31, 2027.

The government also passed Ontario Regulation 338/13 in 2013. It came into force January 1, 2014, and changed the way the WSIB calculates the funding Sufficiency Ratio by changing the method used to value its assets and liabilities. Our Office concurred with this amendment.

The WSIB issues quarterly Sufficiency Reports and an audited Sufficiency Report to stakeholders annually. As of December 31, 2015, under Regulation 141/12 as amended by Regulation 338/13, the WSIB reported a Sufficiency Ratio of 77.9% (in 2014, the Sufficiency Ratio was 71.6%). This means the WSIB has already achieved its December 31, 2017 funding requirement.

The WSIB also submits an annual update of the Sufficiency Plan to the Ministry of Labour by June 30 of each year, in which it describes the measures taken to improve its funding Sufficiency Ratio. The most recent Plan was dated June 29, 2016, and was formally accepted by the Ministry of Labour on September 1, 2016.

The WSIB's operational and financial performance was strong in 2015, as illustrated in **Figure 9**, which provides a summary of the WSIB's operating results and unfunded liability compared to 2014.

The WSIB's continued strong operating performance in 2015 resulted from growth in premium revenues, improved return-to-work outcomes and better-than-expected investment returns (5.8% versus the target of 5.25%).

However, the WSIB's ability to maintain its current funding Sufficiency Ratio, achieve the 2022 and 2027 prescribed funding Sufficiency Ratios, and continue its strong financial performance remains subject to considerable uncertainty regarding future benefit costs, premium revenues and investment returns.

As a result of commitments by the government and the WSIB to address the unfunded liability and the progress the WSIB has made so far, we support the continued classification of the WSIB as a trust for the 2015/16 fiscal year and, therefore, the exclusion of the unfunded liability from the Province's liabilities. However, we will continue to monitor the WSIB's progress on meeting the required funding Sufficiency Ratios and re-evaluate our position as necessary.

Figure 9: Workplace Safety and Insurance Board Operating Results and Unfunded Liability, 2015 and 2014

Source of data: WSIB Financial Statements and WSIB Fourth Quarter 2015 Report to Stakeholders

	2015 ($ million)	2014 ($ million)
Revenue		
Premiums	4,684	4,504
Net investment income	1,199	1,927
	5,883	**6,431**
Expenses		
Benefit costs	3,760	2,623
Loss of Retirement Income Fund contributions	56	59
Administration and other expenses	406	358
Legislated obligations and commitments	263	276
Remeasurement of employee defined benefit plans	(45)	296
	4,440	**3,612**
Total Comprehensive Income	**1,443**	**2,819**
Less: Non-controlling Interests	(152)	(242)
Total Comprehensive Income Attributable to WSIB Stakeholders	**1,291**	**2,577**
Unfunded Liability	**6,599**	**7,890**

It should also be noted that on September 7, 2016, the WSIB provided the Standing Committee on Public Accounts with a status report on its unfunded liability in response to the recommendations pertaining to the WSIB in **Chapter 2** of our *2015 Annual Report*. Specifically, WSIB shared the following key results regarding the Sufficiency Ratio and the unfunded liability:

- As of June 30, 2016, the Sufficiency Ratio reached 82.3%;
- The unfunded liability as of September 7, 2016, stands at $5.6 billion, compared to the high of $14.2 billion reached in December 2011;

WSIB's current projections indicate a likely elimination of the unfunded liability by 2021, which is six years ahead of requirements.

10.0 Ontario Retirement Pension Plan (ORPP) Initiative

On August 5, 2016, the Ministry of Finance requested that our Office undertake a special assignment under Section 17 of the *Auditor General Act* to provide an attest opinion on the accuracy and completeness of the cost estimates for the Ontario Retirement Pension Plan (ORPP) initiative as presented in the summary of ORPP costs. Our Office was requested to report on the schedule of costs for the ORPP initiative for the period from October 1, 2013, to July 15, 2016.

The Province started exploring options for an Ontario supplemental pension plan in October 2013. In 2014, the Province announced plans to proceed with the development of a new mandatory pension plan called the ORPP. In November 2014, the government established the ORPP Implementation Secretariat (Secretariat) to initiate and oversee the policy, legislative and operational foundations of the ORPP. The Secretariat oversaw the establishment of the ORPP Administrative Corporation (Corporation) and undertook governance, plan design, communication and stakeholder engagement, investment strategy and delivery and operations foundational work. The Corporation was responsible for making the pension plan operational and for administering and investing the pension fund as trustee.

In June 2016, Canada's finance ministers met and agreed in principle to enhance the Canada Pension Plan. Following this agreement, the Government of Ontario stated that it would not proceed with establishing the ORPP.

The schedule of costs for the ORPP covers the costs incurred by the Corporation, Secretariat and other Ministry of Finance expenditures. The expenditures for the ORPP initiative were $55.4 million plus provisions for contingent expenditures of $15 million. The schedule was prepared, on an accrual basis, to present all costs associated with the ORPP initiative. Our Office expressed an unqualified audit opinion on the full cost schedule (see **Appendix**).

11.0 Reporting under *Fiscal Transparency and Accountability Act*

Under the *Fiscal Transparency and Accountability Act, 2004* (Act), the Minister of Finance (Minister) is required to release a number of fiscal reports, documents and indicators to the public. Accountability and transparency are enhanced by this enshrining in legislation of a coherent cycle for reporting on the state of Ontario's finances throughout the year.

Sections 5 through 10 of the Act deal with the various reporting requirements, including the deadlines the Minister must meet to release the information to the public:

- *Section 5:* requires the Minister to release a multi-year fiscal plan, as outlined in the Province's budget laid before the Assembly. The fiscal plan must be released to the public each fiscal year. The Minister has released a three-year fiscal plan annually since the Act came into force.

- *Section 6:* requires the Minister to conduct a mid-year review of the fiscal plan, which must be released on or before November 15 each fiscal year. The Province refers to this review as the "Ontario Fall Economic Outlook and Fiscal Review"—otherwise known as the Ontario Fall Economic Statement. The mid-year review has been released on time or within two weeks of the legislated deadline.
- *Section 7:* requires the Minister to release in each year, on or before August 15 and on or before February 15, updated information about Ontario's revenues and expenses for the current fiscal year. The Province refers to these as its "First and Third Quarter Finances", which are scheduled for release on or before August 15 and on or before February 15, respectively. We noted that, while the Minister generally releases the Province's First Quarter Finances before the legislated deadline (August 15), the Third Quarter Finances have been released after the deadline (February 15). The last release of the Third Quarter Finances by the legislated deadline was on January 22, 2013, relating to the 2012/13 fiscal year. There was no release of the Third Quarter Finances for the 2013/14, 2014/15, and 2015/16 fiscal years. However, in respect of these fiscal years, the Minister of Finance notified the Legislative Assembly that the Third Quarter Finances would be included in the annual budgets, noting this would allow for the most complete and up-to-date picture of Ontario finances. For the 2014/15 fiscal year, the First Quarter Finances update was included in the 2014 Ontario Budget and as such a separate first quarter update was not released.
- *Section 9:* requires the Minister to release a long-range assessment of the Province's fiscal environment within two years after each provincial election. The Province refers to this assessment as Ontario's Long-Term Report on the Economy. For 2009 and 2013, Ontario's Long-Term Report on the Economy was released after the legislated deadline. In both cases, the Minister issued a statement to the Legislative Assembly saying the reports would be delayed. An explanation was provided for 2009 and 2013. Most recently, on June 10, 2016, the Minister notified the Legislative Assembly that the June 12, 2016, deadline for the current Long-Term Report would be delayed until later in the fiscal year, but did not explain why the information—a requirement under *Section 11* of the Act—was being released late. As at October 31, 2016, the Long-Term Report on the Economy had not been released.

While *Section 11* of the Act allows the Minister to delay the release of information by issuing a statement to the Legislative Assembly, it does not address how long afterward the Minister must release the information.

RECOMMENDATION 10

To ensure compliance with financial disclosure requirements under the *Fiscal Transparency and Accountability Act, 2004*, the Ministry of Finance should work with the Minister of Finance's office to ensure that:

- the Third Quarter Finances report is prepared and publicly released on a timely basis;
- when there are delays in issuing Ontario's Long-Term Report on the Economy and a letter is tabled to that effect, the letter includes the reasons for the delay; and
- delayed information is tabled as soon as it is available.

MINISTRY OF FINANCE RESPONSE

The Ministry of Finance will continue to ensure that financial disclosures are released on a timely basis and when they are not available, an explanation is provided in accordance with legislation.

12.0 Ongoing Accounting-Standards Matters

As noted previously, it is our view that PSAB standards are the most appropriate for the Province to use in preparing its consolidated financial statements. This ensures that information provided by the government about the surplus or the deficit is fair, consistent and comparable to data from previous years, allowing legislators and the public to assess the government's management of the public purse. It is worth noting that Ontario's provincial budget is also prepared on the same basis as its consolidated financial statements.

However, PSAB faces challenges in reaching a consensus among its various stakeholders, including financial statement preparers and auditors, on what accounting standards are most appropriate for the public sector.

We discuss three significant accounting issues (Financial Instruments, Rate-Regulated Accounting and Transfer Payments) that have posed a significant challenge to PSAB over the past few years. Their final accounting-standard determination will affect the way the Province accounts for these items, and it will have a significant impact on the Province's reported financial results.

12.1 Financial Instruments

Financial instruments include provincial debt, and derivatives such as currency swaps and foreign-exchange forward contracts. PSAB's project to develop a new standard for reporting financial instruments began in 2005, with a key issue being whether changes in the fair value of derivative contracts held by governments should be reflected in their financial statements and, in particular, whether such changes should affect a government's annual surplus or deficit.

In March 2011, PSAB approved a new public-sector accounting standard on financial instruments, effective for fiscal periods beginning on or after April 1, 2015. The new standard provides guidance on the treatment of government financial instruments, and is similar to comparable private-sector standards.

One of its main requirements is for certain financial instruments, including derivatives, to be recorded at fair value, with any unrealized gains or losses on these instruments recorded annually in a new financial statement of remeasurement gains and losses.

Some Canadian jurisdiction preparers, including Ontario, do not support the introduction of these fair-value remeasurements and the recognition of unrealized gains and losses. Ontario's view is that it uses derivatives solely to manage foreign currency and interest-rate risks related to its long-term-debt holdings, and that it has both the intention and ability to hold these derivatives until the debts associated with them mature.

Accordingly, remeasurement gains and losses on the derivatives and their underlying debt would offset each other over the total period that such derivatives are held, and therefore would have no real economic impact on the government.

The government argues that recording paper gains and losses each year would force the Province to inappropriately report the very volatility that the derivatives were acquired to avoid. This, in its view, would not reflect the economic substance of government financing transactions and would not provide the public with transparent information on government finances.

In response to governments' concerns, PSAB committed to reviewing the new financial instruments standard by December 2013. PSAB completed its review of *Section PS 2601, Foreign Currency Translation,* and *Section PS 3450, Financial Instruments,* and in February 2014 confirmed the soundness of the principles underlying the new standard.

PSAB deferred the effective date for these new standards to fiscal years beginning on or after April 1, 2016. In 2015, however, PSAB further extended the effective date for the new standard to April 1, 2019, for senior governments, to allow further study of reporting options for these complex financial instruments.

We continue to recommend ongoing dialogue between our Office and the Office of the Provincial Controller to review areas of common concern as the PSAB reassesses the standard in preparation for implementing it on April 1, 2019.

12.2 Rate-Regulated Accounting

Rate-regulated accounting was developed to recognize the unique nature of entities, such as electric utilities, whose rates are regulated by an independent regulator. In general, it allows the deferral of revenue and expenses to future years. The regulator often allows the entity to recover certain current year costs from the ratepayer in future years, and these deferred costs are typically set up under rate-regulated accounting as assets on the entity's statement of financial position. Under normal accounting principles, these costs would be expensed in the year incurred. We have in recent years raised concerns about the appropriateness of recognizing such assets and liabilities in the province's consolidated financial statements. The absence of rate-regulated accounting would have considerable impact on those entities that follow it.

Rate-regulated accounting is used by three of the Province's government-controlled business enterprises, Ontario Power Generation Inc. (OPG), Hydro One, and Brampton Hydro whose rates to customers are approved by the government-established regulator, the Ontario Energy Board. Rate-regulated accounting treatment is currently allowable under Canadian generally accepted accounting principles. However, we question whether rate-regulated assets should be considered as bona fide assets in the government's consolidated financial statements.

As noted above, rate-regulated accounting provisions outline the need for an independent regulatory body to set rates. We note that, since the government controls both the regulator and the major regulated entities, it has significant influence on which costs Hydro One and OPG will recognize in a given year. This could ultimately affect both electricity rates and the annual deficit or surplus reported by the government.

In our previous annual reports, we outlined that the era of rate-regulated accounting appeared to be ending for jurisdictions like Canada as they were converting to International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB), in 2012. Our comments were based on the fact that, in January 2012, Canada's Accounting Standards Board (AcSB) reaffirmed that all government business enterprises should prepare their financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2012. At that time, IFRS standards did not include accounting provisions that addressed rate-regulated activities and so, by default, IFRS standards did not permit rate-regulated accounting.

However, the rate-regulated accounting landscape has continued to evolve since then. Efforts to harmonize U.S. generally accepted accounting policies (U.S. GAAP) and IFRS were in place as Canada converted to IFRS in 2012. At that time, U.S. GAAP allowed for, and continues to allow for, rate-regulated accounting. The appropriateness of rate-regulated accounting has been discussed as part of the efforts to harmonize U.S. GAAP and IFRS. As these discussions were taking place, Canada's AcSB granted a one-year extension in March 2012 to the mandatory IFRS changeover date for entities with qualifying rate-regulated activities. Multiple one-year extensions to defer adoption of IFRS by these entities followed over the next few years.

An interim IFRS standard was issued in January 2014 as an attempt to ease the adoption of IFRS for rate-regulated entities by allowing them to continue to apply existing policies for their deferred rate-regulated balances upon adoption of IFRS starting on January 1, 2015. Essentially, the interim standard provides a first-time adopter of IFRS with relief from having to derecognize their rate-regulated assets and liabilities until the comprehensive review on accounting for such assets and liabilities is completed by the IASB. The result of this review and the determination of whether rate-regulated accounting will be allowed on an ongoing basis, as opposed to an interim basis, is uncertain at this time.

Rate-regulated accounting has a significant impact on the government's financial statements. For example, OPG recognized $5.7 billion in net rate-regulated assets as of March 31, 2016. Future reporting under IFRS that does not accommodate rate-regulated accounting would increase the volatility of Hydro One and OPG's annual operating results. This in turn would lead to volatility in the Province's annual deficit or surplus and may impact the government's revenue and spending decisions.

We will continue to monitor developments impacting the use of rate-regulated accounting going forward to assess its impact on the Province's consolidated financial statements.

12.3 Transfer Payments

PSAB's Government Transfers project began a number of years ago to address several accounting issues related to monetary and capital asset transfers from one level of government to a recipient, including the following:

- appropriately accounting for multi-year funding provided by one government to another;
- clarifying the authorization needed for transfers to be recognized by both the government making the transfer, and the one receiving it;
- clarifying the degree to which stipulations imposed by a transferring government affect the timing of transfer recognition in the accounts of the recipient governments; and
- appropriately accounting for transfers that are to be used to acquire or construct tangible capital assets.

After substantial discussion and the issuing of several documents for comment, PSAB approved a new standard on government transfers in December 2010, effective for fiscal years beginning on or after April 1, 2012.

One of the most difficult areas PSAB had to address in developing the standard was how recipients should account for multi-year transfers. If the federal government makes a lump-sum transfer near the end of a fiscal year to a province to fund services over several years, the question arises as to whether the province should immediately recognize the full amount of the grant as revenue, or recognize the revenue spread out over the years it provides the federally funded services.

A similar issue arises with respect to capital transfers from the province to entities such as school boards and hospitals. A number of stakeholders held the view that capital transfers should be recognized as revenue when the recipient government incurs the expenditures making it eligible to receive the grant. However, other stakeholders held that such transfers should be brought into revenue over time as the tangible capital asset acquired or constructed with the transferred funds is used to provide public services.

The new standard generally recommends that recipients should recognize a government transfer as revenue when it has been authorized and the recipient has met all eligibility criteria. However, this requirement does not apply when the transferring government creates a liability for the recipient government by imposing stipulations on the use of the transfer, or specifies actions the recipient needs to take to keep the transfer.

The standard also specifies that actions and communications by the recipient that restrict the use of transferred funds for a specific purpose can create a liability. To meet PSAB's liability definition, there must be no discretion to avoid it, there must be a future outflow of economic resources to settle it, and it must be the result of past transactions and events. Whether the facts and circumstances surrounding a particular transfer support the recognition of a liability is a matter of professional judgment. If a transfer is determined to create a liability for the recipient government, the transfer is deferred and recognized as revenue as the liability is settled over time.

As we highlighted in our *2015 Annual Report*, rather than enhancing consistency and comparability in accounting for government transfers, the new standard appears to have created confusion. Its requirements are broad and open to interpretation, resulting in significant differences in its application. This is a concern, because transfers are usually a significant government activity and can have a great impact on reported results. In the 2015/16 fiscal year, Ontario recorded transfer-payment expenses of approximately $54 billion and transfer revenue from the federal government of around $22.9 billion.

Many stakeholders had asked PSAB to consider amending the government transfers standard because of inconsistencies in interpretation and application. PSAB took the view that more empirical evidence is needed before it will consider amending the standard.

One significant area where consensus has been difficult to reach is accounting for transfers received to fund the acquisition or construction of tangible capital assets. Depending on the circumstances, such transfers might be recognized as revenue when received, when the asset has been acquired or constructed, or over the service life of the asset.

While we acknowledge the controversy over this new standard, we believe that it supports the initial accounting of government transfers and external contributions as deferred capital contributions, with both being recorded as revenue over the useful life of the related tangible capital assets based on transfer stipulations and recipient actions and communications. As such, we agreed with $6.9 billion in deferred capital contributions being recorded in 2015/16 in the Province's March 31, 2016, consolidated financial statements ($6.3 billion in 2014/15).

PSAB carried out a post-implementation review of *PS 3410, Government Transfers*, because it was aware of different interpretations and applications of the standard. PSAB hoped this post-implementation review will help it assess implementation challenges encountered by stakeholders, and the nature, extent and cause of any ongoing issues. PSAB noted that it will use responses to the review, along with other procedures, to determine next steps in dealing with the interpretation and application of the standard.

In September 2015, PSAB reported that it had considered the preliminary results of the post-implementation review of *PS 3410, Government Transfers*. PSAB also discussed the options for next steps and requested staff to prepare an options paper for its consideration at a meeting scheduled for December 2015.

PSAB approved a feedback statement on the post-implementation review of *PS 3410, Government Transfers* in April 2016. The findings of the post-implementation review confirmed the primary area of concern is the accounting for capital transfers by recipient. PSAB noted the interpretation of the standard varied between and within preparers and auditors. Both qualified and unqualified audit opinions were issued on financial statements reporting similar transactions and following similar accounting. This does not serve the public interest or meet users' needs. PSAB said it would explore whether an authoritative accounting guideline would help clarify interpretations of the standard to resolve the different interpretation.

In August 2016, PSAB released a commentary in PSAB Matters concluding "status quo" for *PS 3410, Government Transfers* standard. In its commentary, PSAB noted that it had spent nine years of consultation with constituents when they were developing the standard. Flexibility was added to the standard to allow deferred capital contribution accounting under PSAB standards by referencing to the terms of each transfer agreement alone or, in addition to a recipient's own actions and communications, to drive the accounting treatment. PSAB noted that both scenarios require that the liability definition be met, taking into account the requirements of *Section PS 3200, Liabilities*.

The commentary noted that when *Section PS 3410* was approved, it recognized that there could be inconsistency in recipient accounting for capital transfers. However, PSAB noted that since the standard was written with flexibility in mind, eliminating flexibility through a guideline could result in overriding the standard. PSAB concluded that the standard is sufficient on its own and it would not be issuing a guideline. PSAB noted it will only revisit the standard if there is a new potential development such as a new conceptual framework.

Based on the PSAB commentary, we again conclude that Ontario's accounting for deferred capital contribution is consistent with *PS 3410, Government Transfers*.

13.0 Public Sector Accounting Board Initiatives

This section outlines some additional items that PSAB has been studying over the past year that might affect the preparation of the Province's consolidated financial statements in the future.

13.1 Concepts Underlying Financial Performance

PSAB's existing conceptual framework is a set of interrelated objectives and fundamental principles that support the development of consistent accounting standards. Its purpose is to instill discipline into the standard-setting process to ensure that accounting standards are developed in an objective, credible and consistent manner that serves the public interest.

In 2011, PSAB formed the Conceptual Framework Task Force in response to concerns raised by several governments regarding current and proposed standards, which they contend cause volatility in reported results and distort budget-to-actual comparisons. The task force's objective was to review the appropriateness of the concepts and principles in the existing conceptual framework for the public sector.

The task force's first step was to seek input from stakeholders on the building blocks of the conceptual framework; these will form the basis for evaluating the existing concepts underlying the measurement of financial performance. To this end, the task force has issued two consultation papers: *Characteristics of Public Sector Entities and Measuring Financial Performance in Public Sector Financial Statements*.

In March 2015, the task force issued a third consultation paper that proposed a new reporting model and draft principles on public-sector characteristics, financial statement objectives, qualitative characteristics, elements, recognition, measurement and presentation. The comment period ended in August 2015.

The task force is currently developing a Statement of Principles that will take into account input received from the three Consultation Papers and will propose a revised conceptual framework and reporting model for public-sector entities. PSAB expects to approve the Statement of Principles in 2017.

13.2 Asset Retirement Obligations

The objective of this project is to develop a standard that addresses the reporting of legal obligations associated with the retirement of long-lived tangible capital assets currently in productive use. For example, there may be obligations associated with decommissioning an electricity generating facility.

PSAB issued a statement of principles in August 2014 that proposes a new section on retirement obligations associated with tangible capital assets controlled by a public-sector entity. The main features of this statement of principles are:

- A retirement obligation should be recognized when there is a legal, constructive or equitable obligation to incur retirement costs in relation to a tangible capital asset.
- Upon initial recognition, the entity would increase the carrying amount of the related tangible capital asset by the same amount as the liability. Therefore, the initial recognition of an asset retirement obligation will increase net debt reported by a public-sector entity.

- The estimate of a liability for retirement obligation should include costs directly attributable to retirement activities, including post-retirement operation, maintenance and monitoring.
- A present-value technique is often the best method with which to estimate the liability.
- The carrying amount of the liability for a retirement obligation should be reviewed at each financial reporting date.
- Subsequent remeasurement of the liability can result in either a change in the carrying amount of the related tangible capital asset or an expense.

PSAB accepted feedback on the proposals until September 2014. Respondents were in general agreement with the key proposals. The next step in the project is an exposure draft to be issued in the first quarter of 2017.

13.3 Revenue

Two major sources of government revenue—government transfers and tax revenue—are addressed in the sections *PS 3410 Government Transfers* and *PS 3510 Tax Revenues* of the *CPA Canada Public Sector Accounting Handbook* (Handbook). However, the Handbook does not specifically address other revenues.

In September 2011, PSAB approved an amended project proposal on revenues to address the limited guidance in the Handbook on revenues that are common in the public sector. PSAB did not initiate the project to review the existing revenue standards; rather, it aimed to put in place overarching guidance to address questions about when revenues are recognized, and how they are measured and presented in the financial statements.

In August 2013, PSAB issued a Statement of Principles containing proposals that will affect the reporting of a broad range of revenues. The purpose of the project and Statement of Principles is to create a new Section on revenues that would apply to public-sector entities that follow the Handbook.

The Statement of Principles focuses on two main areas of revenue: exchange transactions and unilateral (non-exchange) transactions.

It also:

- notes the presence of performance obligations for the public-sector entity as the distinguishing feature of an exchange transaction;
- defines performance obligations as enforceable promises to provide goods or services;
- recognizes that revenue from an exchange transaction constitutes the public-sector entity's meeting of a performance obligation;
- recognizes unilateral revenues when there is the authority and a past event that gives rise to a claim of economic resources; and
- allows that revenue is not reduced when collectability is uncertain; instead, a corresponding allowance for doubtful accounts is established for the associated receivable.

The next step in the project is for an exposure draft to be issued in the first quarter of 2017.

13.4 Employment Benefits

In December 2014, PSAB approved an Employment Benefits project to improve the existing Handbook sections by taking into account changes in the related accounting concepts and new types of pension plans that were developed since the existing sections were issued decades ago. The project aims to review the existing sections, *PS 3250 Retirement Benefits* and *PS 3255 Postemployment Benefits, Compensated Absences and Termination Benefits*.

The first phase of the project will focus on measurement issues such as the deferral of experience gains and losses, and discount rates. The second phase will address non-traditional pension plans such as shared risk plans, as well as other important topics such as multi-employer defined benefit plans and vested sick-leave benefits.

The first step in the process will be an invitation to comment on the deferral of experience gains and losses to be issued before the end of 2016. A separate invitation to comment on discount rates is planned for 2017.

13.5 Public-Private Partnerships

Public-private partnerships (also referred to as P3s) are increasingly common in the public sector as a way to deliver large public infrastructure projects. In December 2015, PSAB approved a project to develop a standard that addresses recognition, measurement and disclosure matters and provides guidance on how to account for public-private partnerships. PSAB expects to issue a statement of principles in the first quarter of 2017.

14.0 Statutory Matters

Under section 12 of the *Auditor General Act*, the Auditor General is 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 the Auditor General report on any transfers of money between items within the same vote in the Estimates of the Office of the Assembly.

14.1 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 planned spending. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and presents a report on this review to the Legislature. Orders for Concurrence for each of the estimates selected by the Committee, following a report by the Committee, are debated in the Legislature for a maximum of two hours before being voted on. The estimates of those ministries that are not selected are deemed to be passed by the Committee, reported to the Legislature, and approved by the Legislature.

After the Orders for Concurrence are approved, the Legislature still needs to provide its final approval for legal spending authority by approving a Supply Act, which stipulates the amounts that can be spent by ministries and legislative offices, as detailed in the estimates. Once the Supply Act is approved, the expenditures it authorizes are considered to be Voted Appropriations. The *Supply Act, 2016*, which pertained to the fiscal year ended March 31, 2016, received Royal Assent on March 24, 2016.

The *Supply Act* does not receive Royal Assent until after the start of the fiscal year—and sometimes even after the related fiscal year is over—so the government usually requires interim spending authority prior to its passage. For the 2015/16 fiscal year, the Legislature passed two acts allowing interim appropriations—the *Interim Appropriation for 2015-2016 Act, 2015* (Interim Act) and the *Supplementary Interim Appropriation for 2015-2016 Act, 2015* (Supplementary Act). These two acts received Royal Assent on June 4, 2015, and December 10, 2015, respectively, and authorized the government to incur up to $124.1 billion in public service expenditures, $4.9 billion in investments, and $219.5 million in legislative office expenditures. Both acts were made effective as of April 1, 2015, and provided the government with sufficient authority to allow it to incur expenditures from April 1, 2015, to when the *Supply Act, 2016*, received Royal Assent on March 24, 2016.

Because the legal spending authority under the Interim Act and the Supplementary Act was intended to be temporary, both were repealed when the *Supply Act, 2016*, received Royal Assent. The *Supply Act, 2016*, also increased total authorized expenditures of the legislative offices from $219.5 million to $219.6 million.

14.2 Special Warrants

If the Legislature is not in session, section 1.0.7 of the *Financial Administration Act* 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 and approved by the Lieutenant Governor on the recommendation of the government.

No Special Warrants were issued for the fiscal year ended March 31, 2016.

14.3 Treasury Board Orders

Section 1.0.8 of the *Financial Administration Act* 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 government closes the books for the fiscal year. 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 published and tabled in the Legislature.

Even though the *Treasury Board Act, 1991* was repealed and re-enacted within the *Financial Administration Act* in December 2009, subsection 5(4) of the repealed act was retained. This provision allows the Treasury Board to delegate any of its duties or functions to any member of the Executive Council or to any public servant employed under the *Public Service of Ontario Act, 2006*. Such delegations continue to be in effect until replaced by a new delegation. Since 2006, the Treasury Board has delegated its authority for issuing Treasury Board Orders to ministers to make transfers between programs within their ministries, and to the Chair of the Treasury Board for making program transfers between ministries and making supplementary appropriations from contingency funds. Supplementary appropriations are Treasury Board Orders in which the amount of an appropriation is offset by a reduction to the amount available under the government's centrally controlled contingency fund.

Figure 10 summarizes the total value of Treasury Board Orders issued for the past five fiscal years.

Figure 11 summarizes Treasury Board Orders for the fiscal year ended March 31, 2016, by month of issue.

According to the Standing Orders of the Legislative Assembly, Treasury Board Orders are to be printed in *The Ontario Gazette*, together with explanatory information. Orders issued for the 2015/16 fiscal year are expected to be published in *The Ontario Gazette* in December 2016. A detailed listing of 2015/16 Treasury Board Orders, showing the amounts authorized and expended, is included in **Exhibit 4** of this report.

Figure 10: Total Value of Treasury Board Orders, 2011/12–2015/16 ($ million)

Source of data: Treasury Board

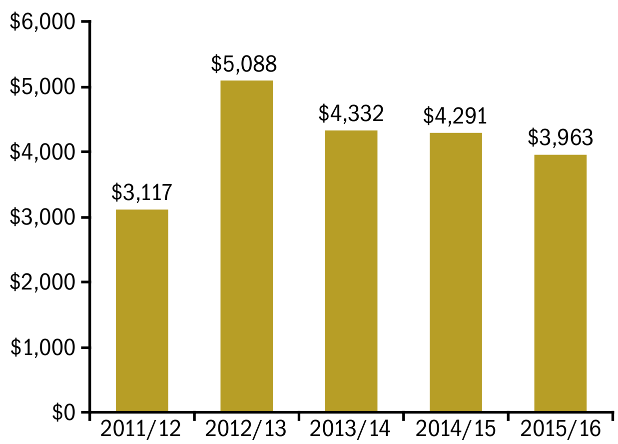


Figure 11: Total Value of Treasury Board Orders by Month Relating to the 2015/16 Fiscal Year

Source of data: Treasury Board

Month of Issue	#	Authorized ($ million)
April 2015–February 2016	67	2,093
March 2016	29	1,444
April 2016	7	115
August 2016	7	310
Total	**110**	**3,963**

14.4 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 our Annual Report.

Accordingly, **Figure 12** shows the transfers made within Vote 202 with respect to the 2015/16 Estimates.

Figure 12: Authorized Transfers Relating to the Office of the Assembly, 2015/16 Fiscal Year

Source of data: Board of Internal Economy

From:		$
Item 5	Office of the French Language Services Commissioner	(28,800)
To:		
Item 1	Environmental Commissioner	28,800

14.5 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 the subject of a settlement or deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2015/16 fiscal year, receivables of $396 million due to the Crown from individuals and non-government organizations were written off. (The comparable amount in 2014/15 was $354.5 million.) The write-offs in the 2015/16 fiscal year related to the following:

- $124.2 million for uncollectible retail sales tax ($107.4 million in 2014/15);
- $98.9 million for uncollectible corporate tax ($101.1 million in 2014/15);
- $65.3 million for uncollectible receivables under the Ontario Disability Support Program ($11.8 million in 2014/15);
- $50.9 million for uncollectible receivables under the Student Support Program ($59.7 million in 2014/15);
- $20.3 million for uncollectible employer health tax ($15.4 million in 2014/2015); and
- $36.4 million for other tax and non-tax receivables ($59.1 million in 2014/15).

Volume 2 of the 2015/16 Public Accounts summarizes the writeoffs by ministry. Under the accounting policies followed in the preparation of the Province's consolidated financial statements, a provision for doubtful accounts is recorded against accounts receivable balances. Most of the writeoffs had already been expensed in the government's consolidated financial statements. However, the actual writeoff in the accounts required Order-in-Council approval.

Appendix: Audited Schedule of Costs for the Ontario Retirement Pension Plan Initiative Prepared by Ministry of Finance

Source of data: Schedule prepared by Ministry of Finance; audit opinion prepared by the Office of the Auditor General of Ontario

Responsibility for Financial Reporting

The accompanying Schedule of Costs for the Ontario Retirement Pension Plan initiative (the "Schedule") has been prepared in accordance with the basis of accounting described in Note 2 to the Schedule. The preparation, presentation and integrity of the Schedule are the responsibility of management. The Schedule includes amounts based on best estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the Schedule is presented properly within reasonable limits of materiality in light of the information available up to September 29, 2016.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to the Ministry.

The Schedule has been audited by the Office of the Auditor General of Ontario. The Auditor's responsibility is to express an opinion on whether the Schedule is prepared, in all material respects, to present on an accrual basis all costs associated with the Ontario Retirement Pension Plan initiative in accordance with the basis of accounting described in Note 2 to the Schedule. The Independent Auditor's Report outlines the scope of the Auditor's examination and opinion.

On behalf of management:

Scott Thompson
Deputy Minister of Finance

Office of the Auditor General of Ontario
Bureau du vérificateur général de l'Ontario

Independent Auditor's Report

To the Minister of Finance

I have audited the accompanying Schedule of Costs for the Ontario Retirement Pension Plan initiative (the "Schedule") for the period from October 1, 2013 to July 15, 2016. The Schedule has been prepared by management based on the financial reporting provisions defined in the basis of accounting section below.

Management's Responsibility for the Schedule

The Ministry of Finance is responsible for the preparation of the Schedule in accordance with the basis of accounting defined in Note 2 to the Schedule and for such internal control as management determines is necessary to enable the preparation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the Schedule based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the Schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Schedule.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the Schedule of Costs for the Ontario Retirement Pension Plan initiative, for the period from October 1, 2013 to July 15, 2016, is prepared in all material respects, in accordance with the financial reporting provisions defined in the basis of accounting section below.

Basis of Accounting and Restriction on Use

Without modifying my opinion, I draw attention to Note 2 of the Schedule which describes the basis of accounting for Ontario Retirement Pension Plan costs. The Schedule was prepared to assist the Ministry of Finance in disclosing costs related to the Ontario Retirement Pension Plan initiative.

Toronto, Ontario
September 29, 2016

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Auditor General

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Schedule of Costs for the Ontario Retirement Pension Plan (ORPP) initiative

For the Period from October 1, 2013 to July 15, 2016 (in thousands of dollars)

Ontario Retirement Pension Plan Administration Corporation (ORPPAC) Expenditures (Note 3)		
Consulting and Professional Services	$	18,357
Salaries and Employee Benefits		5,827
Legal Services		3,260
Other		945
Interest		93
		28,482
Less: Interest Income		(87)
		28,395
Ministry of Finance Expenditures		
Ontario Retirement Pension Plan Implementation Secretariat (ORPPIS)		
Consulting and Professional Services		5,422
Salaries and Employee Benefits		4,693
Legal Services		1,500
Other		827
		12,442
Other Ministry of Finance Expenditures (excluding ORPPIS)		
Advertising Costs		8,208
Salaries and Employee Benefits		5,035
Other		539
Legal Services		396
Consulting and Professional Services		383
		14,561
Expenditures for the ORPP initiative before the undernoted		**55,398**
Provision for Contingent Expenses (Note 4)		15,000
Total Costs for the ORPP Initiative	**$**	**70,398**

Approved by:

Hon. Charles Sousa
Minister of Finance

Scott Thompson
Deputy Minister of Finance

Notes to the Schedule of Costs for the Ontario Retirement Pension Plan (ORPP) Initiative

1. **Background**—In October 2013, the Province began to explore options for an Ontario supplemental pension plan. On May 1, 2014, the Province announced that it was proceeding with the development of a new mandatory pension plan called Ontario Retirement Pension Plan. In November 2014, the government established the ORPP Implementation Secretariat (ORPPIS) to oversee the policy, legislative, governance and operational foundations of the ORPP. In November 2015, the government established an agency responsible for delivering the ORPP; the agency was named the ORPP Administration Corporation (ORPPAC). On June 20, 2016, Canada's finance ministers met and agreed in principle to enhance the Canada Pension Plan. Following this agreement in principle, the Province stated that it would not proceed with establishing the ORPP.
2. **Basis of Accounting**—The Schedule was prepared to present on an accrual basis all costs associated with the Ontario Retirement Pension Plan Initiative. The Schedule of Costs for the Ontario Retirement Pension Plan initiative shows costs incurred by ORPPAC and various other divisions at the Ministry of Finance.
3. **Ontario Retirement Pension Plan Administration Corporation Expenditures**—As of July 15, 2016, the Province had provided $31M in loans to ORPPAC to cover the ORPP start-up and operating costs. In September 2016, the government approved a remission order to forgive the loan and ORPPAC has returned $2.6M to the government from its bank account as surplus funds.
4. **Provision for Contingent Expenses**—The provision for contingent expenses includes the ORPPAC office space lease ($12 M) and other potential vendor and employee costs. The majority of this expense was associated with the office space lease. The Ministry of Infrastructure and Infrastructure Ontario is in the process of transferring the office space lease to the General Real Estate Portfolio of Infrastructure Ontario.