Public Accounts of the Province

1.0 Summary

For the second year in a row, our audit opinion on the province's consolidated financial statements is unqualified. Based on our audit work, we have concluded that the province's consolidated financial statements for 2018/19 are fairly presented and free from material errors.

Instrumental to our issuance of unqualified opinions in 2017/18 and 2018/19 were accounting changes made in 2018 that were maintained in the current fiscal year. The province recorded a full valuation allowance on the pension assets for both the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan, discontinued the inappropriate application of rate-regulated accounting originating with the Fair Hydro Plan, and recorded its full financial impact.

As a result of a change in Canadian generally accepted auditing standards, the auditor's report issued for 2018/19 looks different from previous reports issued. The opinion paragraph and basis for the opinion are now the first two paragraphs included in the report (instead of the last paragraphs under the old format), and there is a new section related to other accompanying information being consistent with the financial statements.

During 2018/19, the province made the decision to discontinue printing Volume 2 of the Public Accounts of Ontario. Volume 2 consisted of the individual financial statements of the significant provincial corporations, boards and commissions whose activities are included in the province's consolidated financial statements. The province instead opted to set up a website with links to the entities' web pages containing financial information. The website includes the financial statements of the broader public sector (i.e., of hospitals, school boards and colleges), which were not included in the printed version of Volume 2. However, all Volume 2 entities' financial statements were not posted and available to the public through the website as early as they were in previous years, when they were printed in Volume 2.

In May 2019, the government repealed the *Fiscal Transparency and Accountability Act, 2004*, and replaced it with the *Fiscal Sustainability, Transparency and Accountability Act, 2019* (Act). The Act requires that the government meet certain reporting requirements and that we review the government's compliance with the Act. The government has met all reporting deadlines as of October 2019.

We audited the Independent Electricity System Operator (IESO) for the year ended December 31, 2018, and issued an unqualified opinion based on the IESO restating prior year balances to correct the accounting for the IESO Administered Market Accounts, rate-regulated accounting and the discount rate used for non-registered pension and other employee benefit plans.

We also audited the Ontario Cannabis Retail Corporation (OCRC) for the year ended March 31, 2019. Because of OCRC issues with the integrated reporting of data from its key IT systems, we performed extensive audit testing and expended considerable time and effort in confirming the reliability and accuracy of information from OCRC's IT systems. On September 5, 2019, we issued an unqualified opinion on the March 31, 2019, financial statements.

The province's growing debt burden with its interest impact on program expenses also remains a concern since we first raised the issue in 2011. This year, as in the past, we present the critical implications of the growing debt for the province's finances.

This year, we revisit two factors that give rise to the province's net pension asset in OTPP before any valuation allowance. The two factors are actual investment returns exceeding expected rates of return and cash contributions exceeding pension expense. In addition, we consider what types of factors or changes in the government environment could lead to a reduction in net pension assets, with a corresponding release of valuation allowance, such as changes in collectively bargained agreements, changes in discount rates used or changes in long-term actuarial assumptions that increase pension expense.

Each year since our *2008 Annual Report*, we have raised the issue of the government legislating accounting practices that may not be consistent with Canadian Public Sector Accounting Standards (PSAS). Ontario legislation does not formally state that Ontario's financial statements should be prepared in accordance with Canadian PSAS. Instead, current legislation permits Ontario to legislate accounting treatments, such as the Fair Hydro Plan. When legislated accounting is used, we have and would continue to highlight this to the Legislative Assembly and the public. Canadian PSAS are the most appropriate accounting standards for the province to use in preparing its 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. The government is working to formalize in legislation the requirement that the province's financial statements will be prepared in accordance with Canadian PSAS.

This chapter contains three recommendations, consisting of four action items, to address our observations.

2.0 Background

Ontario's Public Accounts consist of the province's Annual Report, including the province's consolidated financial statements, and two supplementary volumes of additional financial information. The Public Accounts for the fiscal year ending March 31, 2019, were prepared under the direction of the Minister of Finance, as required by the *Financial Administration Act*, and the President of the Treasury Board.

The government as the governing body is responsible for ensuring that consolidated financial statements, including many amounts based on estimates and judgment, are presented fairly. Senior management in the Ministry of Finance and Treasury Board Secretariat are 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.

Under the *Auditor General Act*, our Office is responsible for the annual audit of these consolidated financial statements. The objective of our audit is to obtain 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 2018/19 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, 2019. Providing such information is intended to enhance the fiscal accountability of the government to both the Legislative Assembly and the public.

The two 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; and
- Volume 3—detailed unaudited schedules of ministry payments to vendors and transfer-payment recipients.

Starting in 2018/19, the previous Volume 2 (audited financial statements of significant provincial corporations, boards and commissions whose activities are included in the province's consolidated financial statements) is no longer part of the Public Accounts. The province has provided a website (**www.ontario.ca/page/public-accounts-ontario-2018-19#section-4**) with links to the web pages of government organizations, trusts under administration, government business enterprises and other government organizations that show their financial statements. In addition, this website also has links to the web pages of consolidated entities from the broader public sector (i.e., hospitals, school boards and colleges), which is additional information not previously contained in the Volume 2 hard copy. However, as noted in **Section 3.7**, many financial statements that were in the Volume 2 (hard copy and soft copy) last year were not available for viewing when the Public Accounts were released this year.

Our Office reviews the information in the province's Annual Report and in Volume 1 of the Public Accounts for consistency with the information presented in the province's consolidated financial statements.

The *Financial Administration 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 deadline for this year was September 27, 2019. The two 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 released the province's 2018/19 Annual Report and consolidated financial statements, along with the two Public Accounts supplementary volumes, on September 13, 2019, meeting the legislated deadline.

The Auditor General's audit opinion on the province's consolidated financial statements was unqualified for the second year in a row. An unqualified opinion in the public sector should be considered just as noteworthy as a qualified audit opinion. An unqualified opinion means that the consolidated financial statements are free from material errors. The unqualified audit opinion on the province's consolidated financial statements is discussed in **Section 3.0** below.

3.0 The Province's 2018/19 Consolidated Financial Statements

3.1 Auditor's Responsibilities

As the Legislature's 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 Canadian Public Sector Accounting Standards (PSAS), so that they give a true and fair view of the financial position and results of the province. It is this independence, combined with the professional obligation to comply with established Canadian Auditing Standards and relevant ethical requirements, that enables the Auditor General to issue an opinion that provides users with confidence in the province's consolidated financial statements.

To enable the Auditor General to form her 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 treatments of certain transactions and analyzing their appropriateness under Canadian PSAS.

Our 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 legislative 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 below.

3.2 Governing Body's and Management's Responsibilities

The auditor's report distinguishes between the responsibilities of the governing body, management and of the auditor with respect to a financial statement audit. Management is responsible for the preparation of the financial statements in accordance with Canadian PSAS. The auditor examines the financial statements in order to express an opinion as to whether the financial statements have been prepared in accordance with Canadian PSAS. The division of responsibility between management and the auditor 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 having 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 individuals within the entity who the auditor determines are necessary to obtain audit evidence. Canadian Auditing Standards are clear on these requirements, and their fulfilment is formally communicated to the auditor in the form of a signed management representation letter at the end of the audit.

When a transaction occurs, it is management's responsibility to identify the applicable accounting standards, determine the implications of the standards on the transaction, decide on an accounting policy and ensure that the financial statements present the transaction in accordance with the applicable financial reporting framework (which for governments is Canadian PSAS). The auditor must be proficient in the applicable financial reporting framework in order to form an independent opinion on the financial statements, and may perform procedures similar to those performed by management to identify the applicable standards and understand the implications of the standards on the accounting transaction. However, unlike management, the auditor does not select an accounting policy or the bookkeeping entries for the organization. These decisions are in the hands of management—in Ontario's case, the Treasury Board Secretariat and the Ministry of Finance, both with support from the Office of the Provincial Controller Division.

The governing body is responsible for overseeing management's processes for identifying risks of fraud and implementing controls to mitigate risks and overseeing the financial reporting process. In addition, the governing body is responsible for reinforcing ethical behaviours through active oversight.

When there are disagreements between an auditor and the governing body and/or management on the application or adequacy of accounting policies, the auditor must assess the materiality or significance of the issue to the overall financial statements in forming the audit opinion. If the issue is material, it results in a qualified opinion, in which the auditor concludes that the financial statements are fairly presented except for the items described 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 consolidated financial statements, but this does not change management's responsibility for the financial statements. Similarly, the government may seek external advice on accounting treatments for 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, change or serve as a substitute for the government's accountability as the preparer of the province's consolidated financial statements.

3.3 The Independent Auditor's Report

The auditor's report used in Canada looks different this year. The changes were approved by the Audit and Assurance Standards Board, which sets Canadian Auditing Standards for financial statements, and were effective for all audits ending on or after December 15, 2018.

The auditor's report, which is issued at the conclusion of an audit engagement, comprises:

- an opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements;
- a basis for the opinion paragraph that explains that the audit was conducted in accordance with Canadian generally accepted auditing standards;
- a new section titled "Other Accompanying Information" that contains the independent auditor's report and explains management's, the governing body's and the auditor's responsibilities for other information and includes the auditor's conclusion about whether the other information is materially consistent with the financial statements or the knowledge obtained in the audit (this section was added because the province prepares other information like annual reports);
- a description of the responsibilities of management and the governing body for the proper preparation and oversight of the financial statements in accordance with the applicable financial reporting framework;
- a description of the auditor's responsibility to express an opinion on the financial statements, conclude on the appropriateness of management's use of the going concern basis of accounting and the scope of the audit; and
- additional paragraphs describing the group audit engagement, communication with those charged with governance, and an explicit statement that the auditor is independent of the entity audited and has fulfilled the auditor's other relevant ethical responsibilities.

The auditor's report may further include:

- an Emphasis of Matter paragraph that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements; and
- an Other Matter paragraph that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to a user's understanding of the audit, the auditor's responsibilities or the auditor's report.

3.4 The Significance of an Unqualified Audit Opinion

The independent auditor's report is the way the auditor communicates to users of the financial statements his or her opinion as to whether the financial statements of an entity are presented fairly. After the audit of the financial statements is completed, the auditor can sign one of four possible opinions:

- **Unqualified, or clean, opinion:** The financial statements present fairly, in all material respects, the financial position and results of the entity.
- **Qualified opinion:** The statements contain one or more material misstatements or omissions.
- **Adverse opinion:** The statements do not fairly present the financial position, results of operations and changes in financial position, as per generally accepted accounting principles.
- **No opinion or disclaimer of opinion:** It is not possible to give an opinion on the statements because, for example, key records of the entity were destroyed and thus unavailable for examination.

An unqualified audit opinion indicates financial statements are reliable. When an auditor issues a qualified opinion, he or she is expressing concern about the entity's compliance with the accounting standards issued by the standard setter (e.g., the Public Sector Accounting Board), or about the auditor's ability to obtain sufficient and appropriate information on the financial statements. An audit qualification is generally a rare occurrence—unqualified opinions are far more frequent. However, the fact that unqualified opinions are common does not mean they are not significant or noteworthy.

For the second year in a row, the Auditor General of Ontario has issued an unqualified opinion on the province's consolidated financial statements. This means that the consolidated financial statements can be relied on to fairly and accurately present the province's fiscal results for the year ended March 31, 2019, in all material respects.

3.5 Key Audit Matters

The Auditing and Assurance Standards Board is proposing, through an exposure draft, to expand the requirements for auditors to communicate key audit matters. If the exposure draft is approved, the Office will need to include key audit matters for the March 31, 2023, audit (effective for years ending on or after December 15, 2022).

Key audit matters could include:

- areas identified as significant risks or involving significant management or auditor judgment;
- areas in which the auditor encountered significant difficulty, for instance in obtaining sufficient and appropriate audit evidence; and
- circumstances that required a modification to the auditor's planned audit approach, including as a result of a significant deficiency in internal control.

The standard on communicating key audit matters is currently discretionary, unless the auditor is required to communicate these matters by law or regulation. We currently communicate significant matters arising from the audit in this chapter of our Annual Report, and we also communicate them during the audit process to senior management and those charged with governance.

3.6 The 2018/19 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 March 31, 2019, is reproduced on the following three pages.

Office of the Auditor General of Ontario
Bureau de la vérificatrice générale de l'Ontario

INDEPENDENT AUDITOR'S REPORT

To the Members of the Legislative Assembly of the Province of Ontario

Opinion

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, 2019, and the Consolidated Statements of Operations, Change in Net Debt, Change in Accumulated Deficit, and Cash Flow for the year then ended, and notes to the Consolidated Financial Statements, including a summary of significant accounting policies.

In my opinion, the accompanying Consolidated Financial Statements present fairly, in all material respects, the consolidated financial position of the Province of Ontario as at March 31, 2019, and the consolidated results of its operations, the consolidated changes in its net debt, the consolidated change in its accumulated deficit and its consolidated cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Basis for Opinion

I conducted my audit in accordance with Canadian generally accepted auditing standards. My responsibilities under those standards are further described in the Auditor's Responsibility for the Audit of the Consolidated Financial Statements section of this report. I am independent of the Province of Ontario in accordance with the ethical requirements that are relevant to my audit of the Consolidated Financial Statements in Canada, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Other Accompanying Information

The Government of Ontario (Government) is responsible for the information in the 2018-19 Public Accounts of Ontario Annual Report.

My opinion on the Consolidated Financial Statements does not cover the other information accompanying the Consolidated Financial Statements and I do not express any form of assurance conclusion thereon.

In connection with my audit of the Consolidated Financial Statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Consolidated Financial Statements or my knowledge obtained during the audit, or otherwise appears to be materially misstated.

If, based on the work I have performed on this other information, I conclude that there is a material misstatement of this other information, I am required to report that fact in this auditor's report. I have nothing to report in this regard.

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Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management 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 management determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Consolidated Financial Statements, management is responsible for assessing the Province of Ontario's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Government either intends to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Province of Ontario's financial reporting process.

Auditor's Responsibility for the Audit of the Consolidated Financial Statements

My objectives are to obtain reasonable assurance about whether the Consolidated Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Consolidated Financial Statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Province of Ontario's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- 3 -

- Conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Province of Ontario's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Province of Ontario to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the Consolidated Financial Statements, including the disclosures, and whether the Consolidated Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.

The audit of the Consolidated Financial Statements is a group audit engagement. As such, I also obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the Consolidated Financial Statements. I am responsible for the direction, supervision and performance of the group audit and I remain solely responsible for my audit opinion.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control identified during the audit.

I also provide those charged with governance with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

Toronto, Ontario	Bonnie Lysyk, MBA, FCPA, FCA, LPA
August 16, 2019	Auditor General

3.7 Volume 2 of the Public Accounts of Ontario

Prior to 2018/19, Volume 2 of the Public Accounts was one of three supplementary reports that the government printed and made available at the same time as the release of the province's consolidated financial statements. It included the audited financial statements of the provincial corporations, boards and commissions whose activities are included in the province's consolidated financial statements, as well as other miscellaneous audited financial statements.

The province is no longer issuing Volume 2 in the same format as the rest of the Public Accounts. Instead, the government has set up a website (**www.ontario.ca/page/public-accounts-ontario-2018-19#section-4**) with links to web pages showing the financial statements of each government organization, trust under administration, business and other type of organization in Schedule 8 of the province's consolidated financial statements.

We have noted that these organizations' financial statements were not all promptly posted on these web pages when the Public Accounts were released on September 13, 2019. In the past, if an organization's audited financial statements were not available at the same time as the release of Public Accounts, a disclosure was made in Volume 2, and the statements were posted to the government's website as they became available. There were only five instances over the past three years when an organization's audited financial statements were not made available at the same time as the release of the Public Accounts.

In contrast, when the province released the 2018/19 Public Accounts on September 13, 2019, the audited financial statements of only 21 out of 66 organizations formerly in Volume 2 were available in the links on the new website. By November 13, 2019, the audited financial statements of an additional 14 agencies were accessible through the website, bringing the total to 35 (53%).

The government also included links for broader-public-sector organizations—specifically, 246 public hospitals, colleges, school boards and school authorities. (The financial statements of these organizations had not been included in the former Volume 2.) Making the financial statements of the broader-public-sector organizations available is a positive step toward improving transparency for the public. On September 13, 2019, 67% of the financial statements of hospitals, colleges, school boards and school authorities were available through the website. By November 13, 2019, the percentage had risen to 96%.

The province's senior management informed us that one key reason for the change from producing a hardcopy Volume 2 to this website was done for cost-efficiency purposes, as it would reduce printing costs. However, the implementation of this change has negatively impacted the timeliness of the availability of the organizations' and agencies' financial statements. These entities, which are part of the consolidated financial statements, are accountable to the responsible Minister (and ultimately to the Legislature and the public) for fulfilling their legislative obligations, effectively managing the resources they use and maintaining the appropriate standards for any services they provide. To perform their duties, they either use public funds allocated to them by the government or generate their own funds. The audited financial statements are a key accountability and transparency mechanism, and the timeliness of their publication is important to maintain their relevance for legislators and the public.

The government established the Agencies and Appointments Directive (for provincial agencies, short-term advisory bodies and special advisors) and the Broader Public Sector Business Documents Directive (for colleges, school boards and hospitals) to set out the rules and accountability for agencies and broader-public-sector organizations and remuneration guidance for government appointments. The Agencies and Appointments Directive includes a requirement for agencies to post their annual reports on a provincial agency or government website within established timelines. (Advisory agencies and agencies with differing legislated requirements are the only exceptions.) The agency's financial statements are included as part of its annual report. The timelines include dates for providing the annual report to the responsible Minister, dates by which the Minister needs to table the annual report in the Legislature and dates by which the entity must publicly post the annual report after tabling. The Agencies and Appointments Directive does not include any guidance or requirements for financial statements to be made available within a specific date separate from the annual report requirements. The Broader Public Sector Business Documents Directive includes a requirement for broader-public-sector organizations to post financial statements on their website within a specific date from their being issued. The date requirements within the Agencies and Appointment Directive and the Broader Public Sector Business Documents Directive do not align with the release of the Public Accounts.

RECOMMENDATION 1

To increase the transparency of the province's consolidated financial statements, we recommend that the Treasury Board Secretariat:

- incorporate electronic copies of the organizations' financial statements, which are consolidated into the Public Accounts, into the Volume 2 website; and
- advise the government to revise the Agencies and Appointments Directive and the Broader Public Sector Business Documents Directive to specify the posting of an agency's audited financial statements on the agency's or government's website no later than the Public Accounts release date.

TREASURY BOARD SECRETARIAT RESPONSE

The province is committed to supporting full transparency and accountability in its reporting to the public, the Legislature and other users.

The change in format of the former Volume 2 of the Public Accounts from a printed version to electronic is consistent with the government's Digital First Initiative. The expansion to include the financial statements of the broader public sector increased transparency for the public. The province will work on ensuring the timely and complete disclosure of the audited financial statements of its consolidated organizations at the time of the release of the Public Accounts.

The Office of the Provincial Controller Division will work with ministries so that financial statements of organizations that were previously published in paper form will be available in digital form at the same time that other supplementary volumes of the Public Accounts are issued each year.

3.8 Update on Net Pension Assets in the 2018/19 Consolidated Financial Statements

As at March 31, 2019, the government reported pension assets before any valuation allowance from the Ontario Teachers' Pension Plan (OTPP) of $16.176 billion ($13.635 billion in 2017/18) and from the Ontario Public Service Employees' Union Pension Plan (OPSEUPP) of $1.105 billion ($1.014 billion in 2017/18), for a total of $17.281 billion ($14.649 billion in 2017/18).

In order to comply with Canadian PSAS, a full valuation allowance against these assets in pension plans the government co-sponsors with its employees continues to be recorded to reflect that the government does not have the unilateral right to reduce its minimum contributions or withdraw surplus without reaching a formal agreement with the plans' other joint sponsors. The government does not have a legally enforceable right to benefit from the pension assets because agreements with the other joint sponsors were not obtained in 2015/16, 2016/17, 2017/18, and 2018/19.

As a result, a full valuation allowance was taken against the pension assets of OTPP and OPSEUPP in the consolidated financial statements of the province for the years ended March 31, 2018 and 2019.

The effect of recording the full valuation allowance against the increasing net pension assets for the OTPP and the OPSEUPP on the consolidated statement of operations was an increase in the province's reported annual deficit for 2018/19 by $2.632 billion ($2.220 billion in 2017/18).

3.8.1 Revisiting Trends in the Province's Net Pension Asset in OTPP

In **Chapter 4**, **Section 4.01** of our *2016 Annual Report*, we examined key concepts underlying the province's pension liability and pension expense, how they are calculated and what factors influence the amounts reported in the consolidated financial statements.

In that section, we highlighted that a pension asset arises when total contributions by the sponsor of a defined-benefit plan plus interest income are greater than all pension expenses since the plan's inception. We explored two factors that give rise to the province's net pension asset in OTPP before any valuation allowance. In particular:

- If a plan trust consistently produces returns that are greater than the expected rate of return, the unamortized actuarial gain balance will grow, and so, too, will the annual amortization of those gains through pension expense. This reduces pension expense over time, which contributes to higher net pension asset balances if all other factors are held constant.
- If cash contributions from plan members and government sponsors exceed pension expense, the net pension asset will grow. This can happen for several reasons, including, but not limited to, pension expense being suppressed by consistently exceptional returns and the fact that funding decisions must be approved by other employers or employees' collective bargaining, which creates a practical barrier to making frequent, short-term adjustments in contribution levels.

Actual Investment Returns Exceed Expected Rates of Return

As at March 31, 2019, the public-sector pension plan with the largest accrued pension benefit asset continued to be that of the OTPP. **Figure 1** shows the OTPP's actual rate of return on plan assets relative to the provincial sponsor's expected rate of return for the last 10 years. Except for two notable exceptions, the OTPP's assets have consistently generated returns well in excess of the province's expected rate of return. The two exceptions were in the year of the global financial crisis (2008), and in the most recent years of US market uncertainty.

The overall trend of strong returns has continued to place pressure on the balance of the pension asset through the ongoing accumulation and subsequent amortization of unamortized actuarial gains.

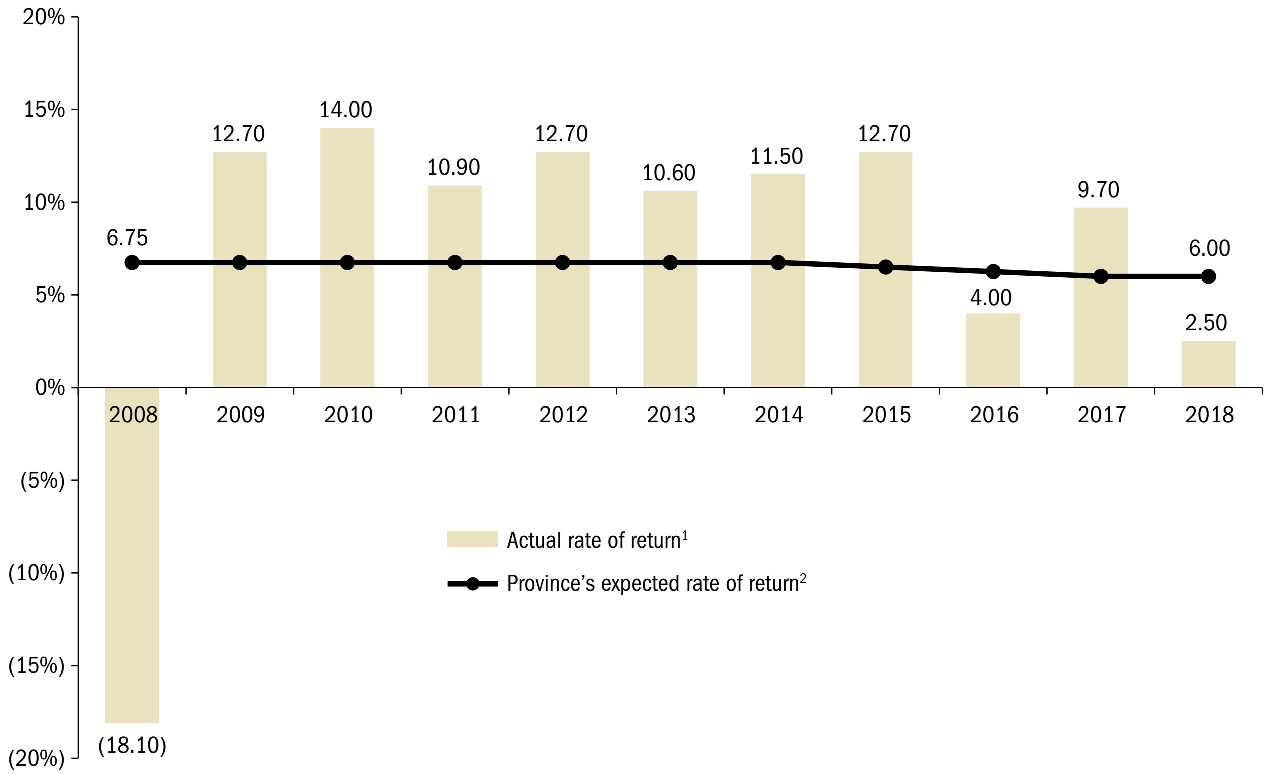
For example, net interest income on the accrued pension asset reduced pension expense by $1,512 million in 2018/19. Amortization of the accumulated actuarial gains also reduced pension expense by a further $923 million for the year ended March 31, 2019.

Cash Contributions Exceeding Pension Expense

While the OTPP's rate of investment returns exceeds the discount rate used by the province to calculate its pension obligations, the province and employee joint sponsors have maintained a consistent level of cash contributions. These two factors combined have resulted in contributions exceeding pension expense, which is the significant driver in the growth of the province's accrued benefit asset in the OTPP.

Figure 1: Ontario Teachers' Pension Plan Actual Rate of Return vs. Province's Expected Rate of Return, 2008–2018

Sources of data: *Ontario Teachers' Pension Plan 2018 Annual Report* and the Public Accounts of Ontario



1. Total-fund net return reported by Ontario Teachers' Pension Plan.
2. As at the beginning of the year.

Figure 2 shows the growth of the accrued benefit asset of the OTPP since the 2009/10 fiscal year and how this is driven by the excess of annual cash contributions over pension expense. The trend of an increasing net pension asset, which continues to grow at an increasing pace, has continued in the three years since we last published this trend analysis.

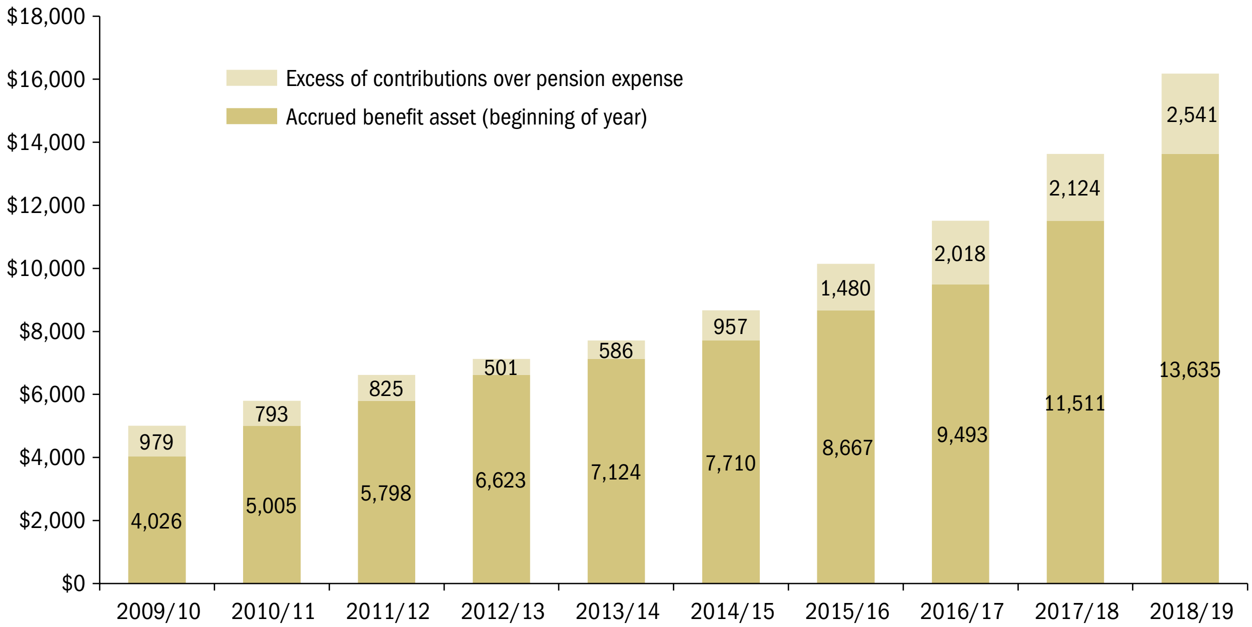
As we noted in our *Review of the 2018 Pre-Election Report on Ontario's Finances*, if not for the recording of a valuation allowance, the province would have recorded pension revenue (instead of pension expense) from the OTPP while continuing to match employees' cash contributions at a steady rate. The widening gap between the government's calculated pension revenue before any valuation allowance and the province's pension contributions to the OTPP totals $6.7 billion over the last three years. The recording of a full valuation allowance eliminates this gap, which avoids distorting the reported resources available for government decision-makers to allocate in their fiscal planning.

3.8.2 Factors that Reduce Net Pension Assets

Much of our published analysis to date has focused on the growing net pension assets of the OTPP and the OPSEUPP and the resulting accounting implications for the consolidated financial statements of the province.

In this section, we consider what types of factors or changes in the government environment could lead to a reduction in net pension assets, with a corresponding release of valuation allowance. The following non-exhaustive list of factors are meant

Figure 2: Ontario Teachers' Pension Plan Accrued Benefit Asset Growth, 2009/10–2018/19 ($ million)
Source of data: Office of the Provincial Controller Division



to be illustrative of the types of changes that could lead to a reversal of the growing accounting trend observed over the past 17 years:

- substantive changes in the negotiated agreements governing the OTPP and the OPSEUPP;
- a change in the discount rate used by the sponsor to measure the pension obligations;
- future underperformance of pension asset portfolios; and
- changes in the long-term actuarial assumptions that increase pension expense.

Changes to Negotiated Pension Agreements

We have examined this factor in some capacity in Chapter 2 of each of our Annual Reports between 2016 and 2018. We continue to engage in open dialogue with the Office of the Provincial Controller Division (OPCD) on the appropriate accounting treatment of any net pension assets of the OTPP and the OPSEUPP.

We have maintained that if the government is able to obtain a formal agreement with the plans' other joint sponsors to take a contribution holiday or reduce minimum contributions, we will need to assess whether the substance of the contractual arrangement would warrant a reversal (in part or full) of the valuation allowance for each plan.

Changes in the Discount Rate Used for Accounting Purposes

Canadian PSAS Section 3250, *Retirement Benefits*, does not prescribe what discount rate the preparer of financial statements should use in calculating a net pension obligation or surplus. Instead, it guides the preparer to use its cost of borrowing or the expected rate of return on plan assets in determining the discount rate. The government has chosen to use the expected rate of return on plan assets, allowing it to set the discount rate for calculating its net pension obligations on the OTPP and the OPSEUPP at 5.80% and 5.75%, respectively, as at March 31, 2019. The historical performance of the pension plans' assets supports these rates.

In contrast, if the province had chosen to use its cost of borrowing to determine its discount rate, the discount rate would have been significantly lower, because the cost of borrowing is typically referenced to the current yield of long-term, publicly traded bonds issued by the province. Borrowing rates also land much closer to the rates used by the OTPP and the OPSEUPP for their own accounting and funding purposes. For example, for its separate audited financial statements, the OTPP discloses that it uses market rates of bonds issued by the province, which have characteristics similar to the OTPP's liabilities. This approach yielded a discount rate of 3.20% as at December 31, 2018.

Regardless of available discount rate options under current standards, we are actively monitoring developments in PSAS for pension plans. The Public Sector Accounting Board (PSAB) is carrying out a project to review Canadian PSAS Section 3250, *Retirement Benefits* and Section 3255, *Post-Employment Benefits*. To date, the project has focused on fundamental issues, such as deferral provisions, discount rate guidance, and non-traditional pension plans. Ultimately, PSAB intends to draft a new standard on employment benefits that replaces Canadian PSAS Sections 3250 and 3255.

PSAB's new standard on employment benefits could potentially have a significant impact on the province's accounting for the net pension assets of the OTPP and the OPSEUPP. In particular, changes to the current discount guidance could have the effect of partially or completely eliminating the net pension assets in both plans. PSAB is considering alternative discount-rate approaches, which include using prescribed rates based on the market yield of high-quality debt instruments or risk-free debt instruments. These bases would also result in a significantly lower discount rate.

To illustrate the significance of the discount-rate assumption, consider that as at March 31, 2019, a decrease in the province's discount rate for the OTPP of 25 basis points would have increased the province's total pension obligation by more than $4 billion. While this change would not show up immediately in the province's total pension liability, it would have a future impact of increasing the pension liability and pension expense over the course of many years.

Therefore, a decrease of 260 basis points (the current difference between the discount rates used by the province of 5.80% and the OTPP of 3.20%) would result in a dramatic increase in the calculated net pension obligation of the OTPP on the consolidated financial statements of the province. A change of this magnitude would very likely eliminate the net pension assets in the OTPP to the point of reporting a plan deficit.

Underperformance of Pension Asset Portfolios

Underperforming pension asset portfolios are not a desirable outcome for government sponsors, pension plan members or pension plans themselves. However, in the event that the OTPP and the OPSEUPP were to experience investment returns that are consistently below the expected rate of return for a sustained period of time, the growth in the net pension asset would slow down, and eventually, given enough accumulated actuarial losses, the net pension asset would begin to grind down. Essentially, the upward force on the net pension asset from the OTPP's recent string of greater-than-expected investment returns would reverse itself in the event of a sustained number of years like 2008 or 2018 (see **Figure 1**).

Changes in Other Long-Term Actuarial Assumptions

Similar to a decrease in discount rates, other changes to long-term actuarial assumptions can increase pension expense and cause the net pension asset to decrease, all other factors being equal. However, it is unlikely that any of these levers individually would have the profound impact that a significant change in the pension discount rate would produce. Nevertheless, they are inputs that affect the mathematics underlying the pension measurement model used by actuaries to determine a sponsor's obligation and annual expense and are therefore worth mentioning. These assumption changes include but are not limited to:

- an increase in inflation rates;

- an increase in salary escalation rates;
- an increase in life expectancy or decrease in mortality; and
- an increase in the average age of retirement.

3.9 Accounting Advisory Services to Entities Consolidated into the Public Accounts

Over the past few years, we have commented on external advisors in this chapter. In our *2017* and *2018 Annual Reports*, we recommended that the Treasury Board Secretariat and OPCD provide us with copies of contracts relating to any advisors it uses for accounting advice and opinions. OPCD provided our Office with three contracts for advisors it engaged for accounting advice in 2016/17, two additional contracts in 2017/18 and one contract for an advisor it engaged in 2018/19. These advisors provided advice and guidance to supplement OPCD's internal analysis of significant accounting issues. OPCD has also agreed to request its external advisors to notify the Auditor General of their engagement, as required under the Code of Professional Conduct of the Chartered Professional Accountants of Ontario.

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 advisors. This is also true of other ministries and agencies consolidated into the financial statements of the province. For this reason, any work performed by external advisors 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 and before final accounting positions are taken. To this end, we are working with the Treasury Board Secretariat, the Ministry of Finance and OPCD to develop guidance that can be used by all ministries and agencies when contracting for accounting advice.

Over the past few years, both OPCD and our Office have assigned designated staff with the purpose of strengthening internal accounting competencies and improving the quality of external financial reporting throughout the Ontario public sector. The two teams of staff have worked closely over the past two years to proactively address accounting issues affecting the Public Accounts.

We are working with OPCD to reduce costs where the procurement of external accounting advice is not needed given the accounting staff expertise in the OPCD and our Office. Early involvement in identifying and addressing accounting issues in the public sector that could impact the province's consolidated financial statements is important and cost effective.

In addition, we have worked with the external auditing firms to safeguard their independence when they perform accounting advisory work for ministries and agencies. As part of the audit of the province's consolidated financial statements, we interact with and use the work of external auditing firms for components identified by us in accordance with Canadian Auditing Standards 600 (*Special Considerations—Audits of Group Financial Statements*). We request that each external auditing firm confirm their independence at the provincial level when responding back to us. To assist with that confirmation, we have requested that the firm confirm that they have not provided accounting advice or accounting advisory services to:

- the Ministry that the entity, for which the firm servers as external auditor, reports into;
- Treasury Board Secretariat; and
- any other ministries, agencies and Crown corporations that are involved in related party transactions with the entity the firm audits.

3.10 Standing Committee on Public Accounts

Over the past few years, the Standing Committee on Public Accounts has held public hearings and issued reports on the Public Accounts of the province. Specifically, reports were tabled on May 17, 2017, related to **Chapter 2** of our

2015 Annual Report (see **Chapter 3 Section 3.06** of Volume 2 (follow-up volume) of our *2018 Annual Report* for the status update on the recommendations made) and May 3, 2018, related to **Chapter 2** of our *2017 Annual Report* (see **Chapter 3 Section 3.04** in the follow-up volume of this year's Annual Report for the status update on the recommendations made). In addition, the Standing Committee on Public Accounts held a public meeting on April 3, 2019, on **Chapter 2** of our *2018 Annual Report*.

The Standing Committee on Public Accounts has covered the following items, amongst others, in their reports related to Chapter 2 over the past few years:

- Ontario's Debt Burden;
- Financial Statement Discussion and Analysis;
- Legislative Accounting;
- Funding of Liabilities for Contaminated Sites;
- The Financial Statements of IESO;
- Pension Accounting in Ontario;
- Use of External Consultants—the Committee had concerns over the independence of external auditing firms and the interaction of the external auditing firms and our Office; and
- Issues Affecting Prior Years' Qualifications—the Committee had concerns over the accounting treatments for rate-regulated accounting, the Fair Hydro Plan, market accounts and the net pension assets of the Ontario Teachers' Pension Plan and Ontario Public Service Employees' Union Pension Plan that gave rise to the qualifications in 2016 and 2017.

4.0 *Fiscal Sustainability, Transparency and Accountability Act, 2019*

In May 2019, the government repealed the *Fiscal Transparency and Accountability Act, 2004*, and replaced it with the *Fiscal Sustainability, Transparency and Accountability Act, 2019* (Act). Under the Act, the government is required to:

- develop a debt burden reduction strategy, including setting out net-debt-to-GDP objectives and plans for reducing the debt burden;
- incorporate sustainability into the province's fiscal policies;
- release the annual Budget by March 31 each year, except for years in which a general election takes place to allow a new government additional time to develop its first multi-year fiscal plan;
- provide a rationale for running deficits in the introductory section of the annual Budget;
- impose monetary penalties on the Premier and the Minister of Finance for missing reporting deadlines stipulated in the Act; and
- post a public statement to explain the rationale for any missed public reporting deadlines, and the revised deadline by which the affected report will be released.

In addition, the Act requires the Auditor General of Ontario to annually review the Minister's compliance with the Act.

Figure 3 shows the reports that are subject to the financial penalty and public statement requirements.

The Auditor General has determined that the communication of the Minister's compliance with the Act will be through Chapter 2.

Figure 4 shows that as of November 6, 2019, the Minister complied with all requirements of the Act.

5.0 Independent Electricity System Operator

As communicated in our *2018 Annual Report*, the Independent Electricity System Operator (IESO) appointed us to perform its December 31, 2018, financial statement audit. We performed our audit procedures between November 2018 and February 2019. We received the full co-operation of

Figure 3: Reports by the Minister of Finance and Premier Subject to Financial Penalty and Public Statement Requirements

Source of data: *Fiscal Sustainability, Transparency and Accountability Act, 2019*

Report	Deadline
Budget	March 31
First-Quarter Finances	August 15
Mid-Year Review (Fall Economic Statement)	November 15
Third-Quarter Finances	February 15
Long-Term Report	Two years following a general election
Quarterly Ontario Economic Accounts	Within 45 days after each of Statistics Canada's Quarterly National Income and Expenditure Accounts

Figure 4: Compliance with Financial Penalty and Public Statement Requirements, May–November 2019

Prepared by the Office of the Auditor General of Ontario

Report	Deadline	Date Available	Requirement Met
First-Quarter Finances	Aug 15, 2019	Aug 15, 2019	Yes
Quarterly Ontario Economic Accounts, First Quarter	Jul 15, 2019[1]	Jul 12, 2019	Yes
Quarterly Ontario Economic Accounts, Second Quarter	Oct 15, 2019[2]	Oct 11, 2019	Yes
Mid-Year Review (Fall Economic Statement)	Nov 15, 2019	Nov 6, 2019	Yes

1. Statistics Canada's Gross Domestic Product and Income and Expenditure Accounts for the first quarter of 2019 were released on May 31, 2019, making the Minister's reporting deadline July 15, 2019.
2. Statistics Canada's Gross Domestic Product and Income and Expenditure Accounts for the second quarter of 2019 were released on August 31, 2019, making the Minister's reporting deadline October 15, 2019.

management and the board. The Auditor General signed an unqualified Independent Auditor's Report on February 27, 2019. The financial statements include a restatement of prior year balances to correct the accounting for the IESO-administered Market Accounts, rate-regulated accounting and the discount rate used for non-registered pension and other employee benefit plans.

At the conclusion of our audit, we agreed with the IESO that it move forward with a request-for-proposal process to appoint a new auditor for its December 31, 2019, financial statement audit. A private auditing firm was selected from a bid process to conduct next year's financial statement audit.

6.0 Ontario Cannabis Retail Corporation

In April 2017, the federal government introduced legislation to legalize and regulate recreational cannabis in Canada. The proposed federal *Cannabis Act* created rules for producing, possessing and selling non-medical cannabis across Canada. On June 21, 2018, the *Cannabis Act* received Royal Assent and the federal government announced that the *Cannabis Act* would come into force on October 17, 2018.

In September 2017, in anticipation of the federal legalization of cannabis, the then government of Ontario announced its plan for the retail and distribution of recreational cannabis in Ontario. Under the proposed approach, the Liquor Control Board of Ontario (LCBO) would oversee the set-up of a separate corporation responsible for the retail of recreational cannabis. The corporation would open approximately 150 stand-alone stores by 2020 and include an online distribution channel. On December 12, 2017, the then government passed the *Ontario Cannabis Retail Corporation Act* (OCRC Act) to establish the Ontario Cannabis Retail Corporation (Corporation), which now operates under the name Ontario Cannabis Store.

Under the initial OCRC Act, the Corporation had the exclusive right to sell recreational cannabis in Ontario through all possible means (online, wholesale and retail). Prior to and during the Corporation's set-up and initial operations, the LCBO worked with the government to draft the strategic vision for the development and implementation of the Corporation's business model. Under the LCBO's direction, the Corporation decided to adopt a cloud-based approach for its information technology (IT) systems. Those systems included e-commerce for online sales, the general ledger system and the payroll system. The Corporation relied primarily on outsourced IT systems and services, including for its accounting and financial reporting—a first for a government agency in Ontario. For example, the Corporation contracted with Shopify to deliver an IT solution that would allow it to manage its retail and e-commerce operations, and be integrated with its inventory, distribution, supply chain, accounting and finance systems.

In August 2018, following the 2018 Ontario provincial election, the new government announced that it was introducing a private retail model and that the Corporation would not run physical retail stores. Up until this point, the Corporation was operating under the assumption that it would be responsible for both physical and online retail channels, and had incurred start-up costs in preparation for the launch of its physical retail stores. Effective October 17, 2018, the government amended the OCRC Act to prohibit the Corporation from operating its own retail stores. The Corporation retained the exclusive right to sell cannabis in Ontario both online and wholesale to licensed cannabis retail stores.

On October 17, 2018, the Corporation began selling recreational cannabis online to consumers in Ontario. Shortly after opening for business, the Corporation encountered significant difficulties in processing the high volume of sales orders and making timely deliveries to customers. During the Corporation's first two weeks of sales, the Office of the Ombudsman of Ontario received more than 1,000 complaints about the Ontario Cannabis Store—most commonly regarding delayed deliveries, billing and poor customer service issues. Some of the delays and billing problems stemmed from issues that the Corporation was experiencing with the communication between its various IT systems. In addition, rotating labour action at Canada Post impacted the Corporation's ability to make timely deliveries to its customers.

As appointed under the OCRC Act, we conducted the audit of the Corporation's financial statements for the fiscal year ended March 31, 2019. During this fiscal year, the Corporation encountered data integration issues with its key IT systems. As a result, we performed extensive audit testing to confirm the reliability and accuracy of information from the Corporation's IT systems. At the time of writing, the Corporation was actively working toward resolving their ongoing data integration issues.

On September 5, 2019, the Auditor General issued an unqualified opinion on the Corporation's financial statements for the fiscal year ended March 31, 2019.

RECOMMENDATION 2

In order for the Ontario Cannabis Retail Corporation to operate effectively, we recommend that it develop a plan and take all steps necessary to expedite the resolution of data integration issues between its key IT systems.

ONTARIO CANNABIS RETAIL CORPORATION RESPONSE

The Ontario Cannabis Retail Corporation, operating as the Ontario Cannabis Store (OCS), is finalizing its resolution plan, with timelines and accountabilities to address the issues. The OCS currently expects to automate and internalize its external sales audit tool by January 2020 and advises that it has accelerated continuing efforts to strengthen data integrations between IT systems with a more robust and reliable data architecture, for completion in mid-2020.

7.0 Ontario's Debt Burden

We commented in previous annual reports on Ontario's growing debt burden, attributable to Ontario's large deficits and its investments in capital assets such as infrastructure. We do so again this year.

In reporting on the province's debt burden, the government restated Ontario's debt figures in the 2018/19 consolidated financial statements. Specifically, the government reduced the total debt from the Ontario bonds and treasury bills repurchased and held by the province in order to be in accordance with Canadian PSAS.

As a result, Ontarians now have a truer picture of Ontario's debt. 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, as illustrated in **Figure 5**. The three measures of debt are defined below:

- *Total debt* is the total amount of borrowed money the government owes to external parties, and consists of bonds issued in public capital markets, non-public debt, treasury bills and US 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.

Figure 5: Total Debt, Net Debt and Accumulated Deficit, 2013/14–2021/22 ($ million)

Sources of data: March 31, 2019, Province of Ontario Consolidated Financial Statements; 2019 Ontario Budget; 2019 Ontario Economic Outlook and Fiscal Review; and the Ministry of Finance

	Actual						Estimate		
	2013/14	2014/15	2015/16	2016/17	2017/18[1]	2018/19[1]	2019/20	2020/21	2021/22
Total debt[2]	292,196	311,762	321,191	325,128	337,411	354,264	378,319	385,700	394,000
Net debt[3]	276,169	294,557	306,357	314,077	323,834	338,496	353,743	365,822	375,719
Accumulated deficit[3]	184,835	196,665	203,014	205,939	209,023	216,642	224,666	230,330	234,749

1. March 31, 2019 Province of Ontario Consolidated Financial Statements.
2. Restated for the buyback of Ontario's own bonds and treasury bills.
3. Restated and as per the 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review, and the Ministry of Finance.

7.1 Main Contributors to Net Debt

The province's growing net debt is attributable to its large annual operating deficits, along with its expenditures on capital assets such as buildings and other infrastructure and equipment, whether acquired directly or through public-private partnerships. This extends to assets acquired for the government or its consolidated organizations, such as public hospitals, as illustrated in **Figure 6**.

The province will continue to have annual deficits over the next three years, and net debt will continue to rise as the government borrows to finance its operations.

In the last 10 years, Ontario's net debt has increased by 99.6%, from $169.6 billion beginning in 2009/10 to $338.5 billion in 2018/19, and is estimated to increase by an additional $37.2 billion, or 11%, in the next three years, resulting in an overall increase of 122%. We estimate net debt will be $375.7 billion by 2021/22.

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 $13,162 per person at the beginning of 2009/10 to about $24,900 per person in 2021/22. In other words, it would cost every Ontarian $24,900 to eliminate the province's net debt in 2021/22. In 2018/19, the amount of net debt owed by each resident of Ontario was $23,633.

7.2 Ontario's Ratio of Net Debt to GDP

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

Figure 6: Net Debt Growth Factors, 2012/13–2021/22 ($ million)

Sources of data: March 31, 2019, Province of Ontario Consolidated Financial Statements; 2019 Ontario Budget; 2019 Ontario Economic Outlook and Fiscal Review; and the Ministry of Finance

	Restated Net Debt Beginning of Year[1]	Deficit/ (Surplus)[1]	Expenditures on Capital Assets[2]	Miscellaneous Adjustments[3]	Restated Net Debt End of Year[1]	Increase/ (Decrease)
Actual						
2012/13	241,912	10,662	7,784	(411)	259,947	18,035
2013/14	259,947	11,530	5,600	(908)	276,169	16,222
2014/15	276,169	11,268	6,509	611	294,557	18,388
2015/16	294,557	5,346	5,471	983	306,357	11,800
2016/17	306,357	2,435	4,752	533	314,077	7,720
2017/18	314,077	3,672	6,584	(499)	323,834	9,757
2018/19	323,834	7,435	7,000	227	338,496	14,662
Estimated						
2019/20	338,496	9,000	11,600	(5,353)	353,743	15,247
2020/21	359,943	6,700	11,000	(5,621)	365,822	12,079
2021/22	372,300	5,400	10,400	(5,903)	375,719	9,897
Total over 10 years	**–**	**73,448**	**76,700**	**(16,341)**	**–**	**133,807**

1. Restated for the net pension assets and the Fair Hydro Plan.
2. Includes expenditures on 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 for fiscal years 2012/13 to 2018/19.
3. Unrealized Fair Value Losses/(Gains) on the Ontario Nuclear Funds Agreement (ONFA) Funds held by Ontario Power Generation Inc. and accounting changes.

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, if the ratio is rising—it means the government's net debt is rising faster than the provincial economy and is becoming a growing burden.

Figure 7 shows that the province's net debt-to-GDP ratio remained constant from 2003/04 (27.5%) to 2007/08 (26.6%). However, it has been trending upward since then, reflecting factors such as significantly increased borrowing to fund annual deficits and infrastructure spending. Ontario's net-debt-to-GDP ratio rose from 26.6% before the 2008/09 recession to 39.6% in 2018/19. We project Ontario's net debt will increase by $37.2 billion over the next three years, resulting in the net-debt-to-GDP ratio rising to 39.8%.

The previous government committed to reducing the net-debt-to-GDP ratio to its pre-recession level of 27% by 2029/30 but excluded it from its 2018 Budget. In the 2019 Budget, the current government introduced the *Fiscal Sustainability, Transparency and Accountability Act, 2019* (Act), a revised framework from the previous *Fiscal Transparency and Accountability Act, 2004*. The Act requires the government to develop a debt burden reduction strategy that aims to have the net-debt-to-GDP ratio at levels less than 40.8% by 2022/23, as announced in the 2019 Provincial Budget. This includes a requirement for the Minister of Finance to set out in the annual budget the government's net-debt-to-GDP ratio and its plans for reducing the debt burden and monitoring progress on doing so. The government, legislators and the public need to be mindful of Ontario's debt level and the relationship of net debt to GDP.

We noted in our previous Annual Reports 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 that it is an oversimplification to rely on just one measure to assess a government's borrowing capacity, because that measure does not take into account that government's share of federal and municipal debts. In Ontario's case, if the province's share of those debts was included in its indebtedness calculations, the net debt would be considerably higher. However, consistent with debt-measurement methodologies used by most jurisdictions, we have focused throughout our analysis predominantly on the provincial government's direct net debt.

Figure 8 shows the net debt of Ontario compared to other provinces and the federal government, along with their respective ratios of net debt to GDP for the 2017/18 and 2018/19 fiscal years. Generally, the western provinces have a significantly lower net-debt-to-GDP ratio than Ontario and the Atlantic provinces, and Quebec has a higher ratio than Ontario.

Figure 7: Ratio of Net Debt to Gross Domestic Product (GDP), 2003/04–2021/22

Sources of data: March 31, 2019, Province of Ontario Annual Report–Financial Statement Discussion and Analysis; 2019 Ontario Budget; and the 2019 Ontario Economic Outlook and Fiscal Review

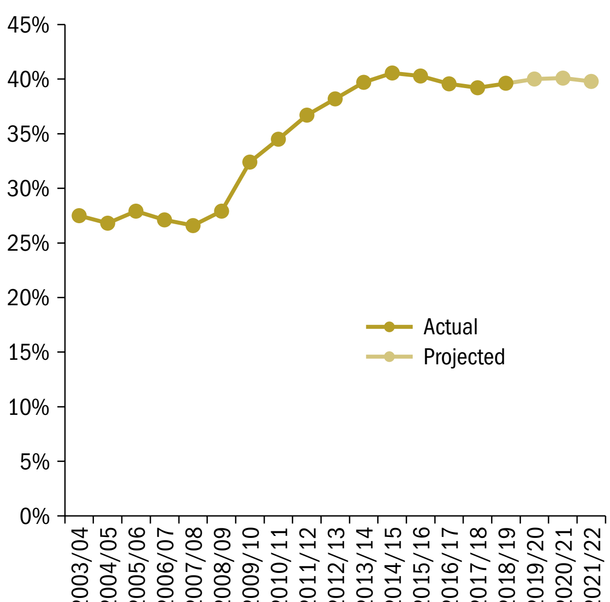


Figure 8: Net Debt and the Net-Debt-to-GDP Ratios of Canadian Jurisdictions, 2017/18 and 2018/19

Sources of data: Province of Ontario Annual Report and Consolidated Financial Statements; Annual Reports and Consolidated Financial Statements of other provincial jurisdictions; and federal budgets and budget updates, budgets and Ministry of Finance report of provincial jurisdictions

	2017/18		2018/19	
	Net Debt ($ million)	Net Debt to GDP (%)	Net Debt ($ million)	Net Debt to GDP (%)
AB	19,344	5.8	27,477	7.9
SK	11,288	14.2	11,834	14.4
BC	41,834	14.8	42,134	14.3
PE	2,129	32.0	2,124	30.5
MB	24,365	34.5	24,999	34.6
NS	14,959	35.0	15,011	34.1
Federal	752,887	35.2	772,124	34.8
NB	13,926	38.6	13,959	37.4
ON	323,834	39.2	338,496	39.6
QC	176,543	42.3	172,558	39.7
NL	14,674	45.2	15,374	44.7

7.3 Other Measures to Assess Government Debt Levels

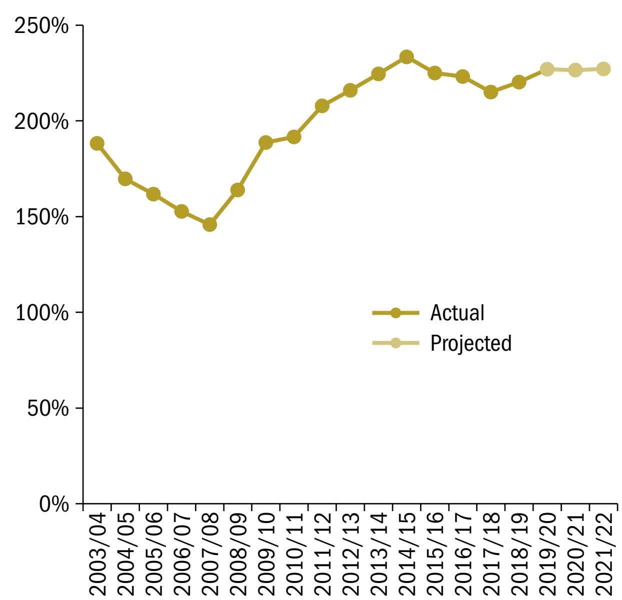
7.3.1 Net Debt as Percentage of Total Annual Revenue

Another useful measure of government debt is net debt as a percentage of total annual revenue, an indicator of how much time it would take to eliminate the debt if the province spent all of its revenues only on debt repayment. For instance, a percentage of 250% indicates that it would take 2.5 years to eliminate the provincial debt if all revenues were devoted exclusively to it.

As shown in **Figure 9**, this percentage declined from about 188% in 2003/04 to about 146% in 2007/08, reflecting the fact that the province's net debt grew at a slower pace than annual provincial revenue. However, the percentage has increased steadily since 2007/08, and is expected to reach 227% by 2021/22. The percentage currently sits at 220%. This increasing percentage indicates the province's net debt burden has relatively less revenue to support it.

Figure 9: Net Debt as a Percentage of Total Annual Revenue, 2003/04–2021/22

Sources of data: March 31, 2019, Province of Ontario Annual Report–Financial Statement Discussion and Analysis; 2019 Ontario Budget; 2019 Ontario Economic Outlook and Fiscal Review; and the Ministry of Finance



7.3.2 Ratio of Interest Expense to Total Revenue

Interest expense is the cost of servicing total debt. Increases in interest expense can directly affect the quantity and quality of programs and services that the 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. In the 2019 Ontario Economic Outlook and Fiscal Review, the government forecast that in 2019/20, it would spend $12.9 billion in interest payments to service the province's debt.

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 10** shows, interest rates have been at historic lows since the beginning of this decade, and the actual interest-expense-to-total-revenues ratio held steady at around 9.0% from 2010/11 to 2014/15. In 2016/17, the government retroactively consolidated the broader public sector on a line-by-line basis, which increased both interest expense and revenue reported in the province's consolidated financial statements. The ratio stood at 8.1% in 2018/19 and is projected to be 8.4% in 2021/22. This means approximately 8.4 cents of every dollar in government revenue will go towards paying interest on debt by 2021/22.

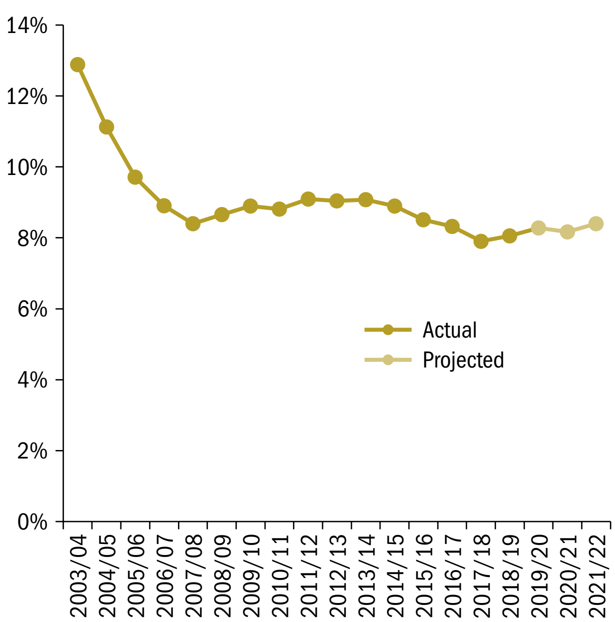
The debt exposes the province to further risks, the most significant being interest-rate risk. As noted above, interest rates in the past few years have been at record low levels, enabling the government to keep its annual interest expense relatively steady even as its total borrowing has increased significantly. Interest rates began to rise in 2017/18 until October and remained unchanged for the remainder of the fiscal year. The risk remains that if interest rates increase, the government will have considerably less flexibility to provide public services, such as health care and education, because a higher proportion of revenues will be required to pay interest on the province's outstanding debt.

As we noted in previous Annual Reports, 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. However, the Bank of Canada raised its key lending rate twice between April 1, 2018, and November 13, 2019. When the government refinances debt at a higher interest rate than that paid on maturing debt, then the average interest expense on government debt will rise. This means more money will go towards interest expense, therefore contributing to increasing the annual deficit.

The ratio of interest expense to revenue is expected to continue to rise in the near future as more interest will be paid on the accumulated debt, meaning the government will have less flexibility to respond to changing economic circumstances. Past governments' borrowing and debt-servicing decisions mean a growing portion of revenues will not be available for other current and future government programs.

Figure 10: Ratio of Interest Expense to Total Revenue, 2003/04–2021/22

Sources of data: March 31, 2019, Province of Ontario Annual Report–Financial Statement Discussion and Analysis; 2019 Ontario Budget; and the 2019 Ontario Economic Outlook and Fiscal Review



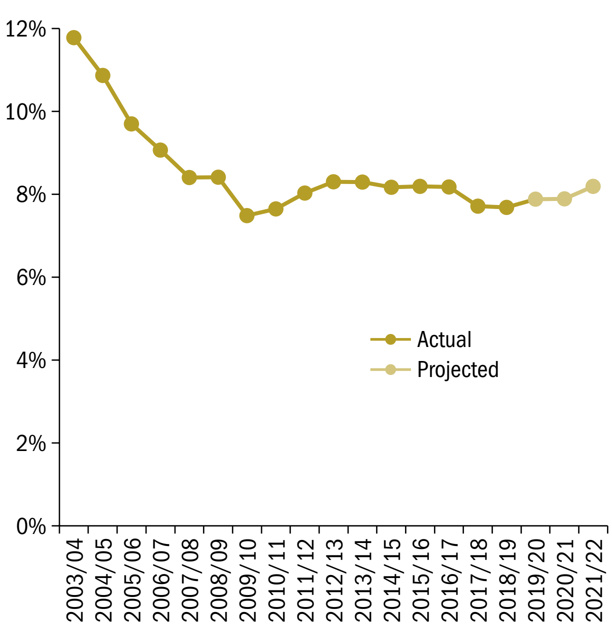
7.4 Consequences of High Indebtedness

Our commentary last year highlighted the consequences for the province of carrying a large debt load—and the same observations remain 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, interest expense is currently the province’s fourth-largest annual expenditure behind health, education, and children’s and social services. As shown in **Figure 11**, interest rates have been at historic lows since the beginning of this decade, and actual interest-expense-to-total expenses has ranged from 7.7% to 8.3% between 2010/11 and 2018/19. In the 2019 Ontario Economic Outlook and Fiscal Review, the province forecast interest expense would increase to $12.9 billion, or about 8.4% of total expenses, by 2021/22.

Figure 11: Interest Expense to Total Expense, 2003/04–2021/22

Sources of data: March 31, 2019, Province of Ontario Consolidated Financial Statements; 2019 Ontario Budget; 2019 Ontario Economic Outlook and Fiscal Review; and the Ministry of Finance



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 2018/19. However, if interest rates start to rise again, the government will have considerably less flexibility to provide public services because it will have to devote a higher proportion of its revenue to interest payments.

Potential credit-rating downgrades could lead to higher borrowing costs: Prepared by specialized agencies, credit ratings assess a government’s creditworthiness based largely on its capacity to generate revenue to service its debt. The four main credit rating agencies are Moody’s Investors Service (Moody’s), Standard and Poor’s Global Ratings (S&P), DBRS Morningstar (previously DBRS), and Fitch Ratings (Fitch). To assign a rating, agencies consider such factors as a government’s economic resources and prospects, industrial and institutional strengths, financial health, financial management and debt management practices, liquidity, access to capital, and susceptibility to major risks.

In 2018, Moody’s downgraded its rating for Ontario’s debt from Aa2 to Aa3, and Fitch revised its rating outlook from stable to negative, reflecting their assessment of the province’s increased credit risk. In 2019, Moody’s’ rating and outlook remained unchanged, while Fitch revised the rating outlook to stable. DBRS Morningstar and S&P have issued unchanged ratings since 2009 and 2015 respectively. The four main agencies cited several concerns regarding Ontario’s credit outlook, including the province’s high and rising debt burden, the projection of ongoing deficits, and the risk of a future economic downturn.

A credit rating can affect the cost of future borrowing, with a lower rating indicating that an agency believes there is a relatively higher risk that a government will default on its debt. Generally, 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.

7.5 Final Thoughts on Ontario's Debt Burden

Ultimately, decisions about how much debt the province should carry, and the strategies to pay down that debt, are questions of government policy and thus the sole prerogative of the government.

Government debt has been described as a burden on future generations, especially debt used to finance operating deficits (in contrast to debt used to finance infrastructure, which is more likely to leave behind tangible capital assets that benefit future generations). In the 2019 Budget, the government aimed to have the net-debt-to-GDP ratio at less than 40.8% by 2022/23.

Our Office performed a value-for-money audit on the Ontario Financing Authority's management of the province's debt (see **Chapter 3, Section 3.10**), and its recommendations are also applicable here.

8.0 Update on Workplace Safety and Insurance Board

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.

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 would not be able to 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 Ontario 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 at the time also passed Ontario Regulation 338/13 in 2013. It came into force on 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.

Figure 12: Workplace Safety and Insurance Board (WSIB) Operating Results and Unfunded Liability, 2018 and 2017 ($ million)
Source of data: WSIB Financial Statements

	2018	2017
Revenue		
Net premiums	4,956	4,779
Net investment (loss) income	(519)	2,914
	4,437	**7,693**
Expenses		
Benefit costs	1,827	3,147
Loss of Retirement Income Fund contributions	56	56
Administration and other expenses	474	409
Legislated obligations and commitments	269	252
Remeasurement of employee defined benefit plans	(268)	273
Other items	(86)	32
	2,272	**4,169**
Total Comprehensive Income	**2,165**	**3,524**
Less: Non-controlling Interests	(29)	309
Total Comprehensive Income Attributable to WSIB Stakeholders	**2,194**	**3,215**
Net Assets (Unfunded Liability)	**1,484**	**(710)**

The WSIB issues quarterly Sufficiency Reports and an Economic Statement to stakeholders annually. As of December 31, 2018, under Regulation 141/12 as amended by Regulation 338/13, the WSIB reported a Sufficiency Ratio of 108.0% (in 2017, the Sufficiency Ratio was 95.8%). This means the WSIB has already achieved its December 31, 2027, funding requirement.

The WSIB now incorporates its annual update of the Sufficiency Plan within the Economic Statement, in which it describes the measures taken to improve its funding Sufficiency Ratio. The most recent plan is available on the WSIB website.

The WSIB's operational and financial performance was strong in 2018, as illustrated in **Figure 12**, which provides a summary of the WSIB's operating results and unfunded liability compared to 2017.

The WSIB's continued strong operating performance in 2018 resulted from premiums exceeding what was needed to cover claims and administrative costs, fewer claims, and better recovery and return to work.

9.0 Use of Legislative Accounting Standards

Canadian PSAS have been widely adopted by Canadian federal, provincial, territorial and local governments as the basis for preparation of their financial statements.

Over time, standards were developed to address increasingly complex transactions and emerging financial issues. When changes to standards have a significant impact on the accounting for and measurement of transactions affecting the annual deficit/surplus or net debt, governments may be reluctant to adopt them to the extent that they generate potential volatility in annual reported results.

As discussed in our *2018 Annual Report*, the previous government passed legislation in 2008, 2009, 2011 and 2012 giving it the ability to make regulations for specific accounting treatments in place of the wholesale application of independently established accounting standards. Initially, the use of regulations did not deviate materially from Canadian PSAS. For example:

- 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 US generally accepted accounting principles (GAAP), effective January 1, 2012. Subsequently, the *Financial Administration Act* was changed to make this regulation no longer apply to Hydro One once it made its initial public offering on the Toronto Stock Exchange in 2015. The government also required another wholly owned government business enterprise, Ontario Power Generation (OPG), to prepare its financial statements in accordance with US GAAP. When the government chose to use US GAAP, rather than International Financial Reporting Standards (IFRS) as required by Canadian PSAS, to record the results of Hydro One and OPG in the province's consolidated financial statements, we examined the differences between IFRS and US GAAP, and concluded these differences had no material effect on the province's annual deficit. The government adopted IFRS for the purposes of recording the results of OPG and Hydro One in the province's March 31, 2017, consolidated financial statements.
- Ontario government regulations require transfers for capital acquisitions and transfers of tangible capital assets to be accounted by 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. This prescribed accounting treatment is in accordance with PSAS.

Subsequent to 2011, regulations and legislation were used to deviate from Canadian PSAS as follows:

- 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. This legislated provision was used in connection with the preparation of the 2015/16 consolidated financial statements. A time-limited regulation was passed requiring a full valuation allowance to be recorded for jointly sponsored pension plans, which while in effect was in accordance with Canadian PSAS.
- Most recently, as noted in our Special Report titled *The Fair Hydro Plan: Concerns about Fiscal Transparency, Accountability and Value for Money*, we expressed concerns about the government legislating a complex accounting/financing structure to improperly avoid showing an annual deficit and increases in net debt. The "legislated accounting" referred to the government creating a regulatory asset through legislation. This "asset" represented the difference between what electricity generators are owed and the lesser amount being collected from electricity ratepayers as a result of the government policy decision to reduce electricity rates without the involvement of an independent regulator. Without the legislated accounting, the difference would be recorded as an expense rather than as an asset in the province's consolidated financial statements. As described in our *2018 Annual Report*, the government corrected the accounting to comply with PSAS in the March 31, 2018, consolidated financial statements.

We have raised the issue of legislated accounting 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 principles, specifically those of Canadian PSAS, in order to maintain its financial reporting credibility, accountability and transparency.

If the government reports a deficit or surplus under a legislated accounting treatment that is materially different than what it would be using Canadian PSAS, the Auditor General is compelled to include a qualification in her audit opinion.

RECOMMENDATION 3

To ensure consistent use of Canadian Public Sector Accounting Standards, we recommend that the government formalize a process to follow the accounting standards established by the Canadian Public Sector Accounting Board to avoid using legislation or regulations to prescribe accounting treatments.

TREASURY BOARD SECRETARIAT RESPONSE

The province is committed to preparing its financial statements in accordance with generally accepted accounting principles in order to provide high-quality financial reports that support transparency and accountability in reporting to the public, the Legislature and other users.

10.0 Ongoing Accounting Standards Matters

Canadian PSAS continue to be the most appropriate standards for the province to use in preparing its consolidated financial statements. Following PSAS ensures that information provided by the government about the annual deficit or surplus is fair, consistent and comparable to previous years, allowing legislators and the public to assess the government's management of the public purse. Ontario's provincial budget is also prepared on the same basis as its consolidated financial statements.

However, the Public Sector Accounting Board (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 that have posed a significant challenge to PSAB over the past few years: the use of financial instruments in the public sector, the use of rate-regulated accounting in government business enterprises and accounting for public-private partnerships. PSAB's final accounting-standard determination will affect the way the province accounts for these items and will have a significant impact on the province's reported financial results.

10.1 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 deficit or surplus.

In March 2011, PSAB approved a new public-sector accounting standard on financial instruments that was slated to become 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 financial-statement preparers in Canadian jurisdictions, 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.

Ontario financial-statement preparers argue 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 their 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 such 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 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. In 2018, PSAB further extended the effective date for the new standard to April 1, 2021, and will be issuing an exposure draft to improve the transitional provisions and potentially address other non-hedge accounting issues raised during the consultation process.

Since February 2016, PSAB staff have been consulting with the government and not-for-profit stakeholders on implementation issues of the financial-instruments standard. The senior government community has communicated the need for a hedge accounting standard during these consultations. PSAB noted that its staff, in collaboration with stakeholders, have identified certain timing issues in the new financial-instruments standard that may impact a government's annual surplus or deficit in a manner that is unrepresentative of the underlying transactions. In its *Section PS 2601, Foreign Currency Translation*, PSAB stated that given "responses to due process documents issued during the financial instruments project, and the lack of consensus internationally on a hedge accounting model, PSAB has decided to adopt an approach that does not include hedge accounting." PSAB reconfirmed its decision to exclude a formal hedge accounting standard from the PS 3450 suite of standards at its Board meeting in March 2018.

In January 2019, PSAB released an exposure draft for comment containing narrow-scope amendments to PS 3450. At present, PS 3450 would require the province to derecognize its repurchased debt, which could result in gains or losses recorded to the statement of operations. PSAB is proposing to change PS 3450 so that the province would not need to derecognize the repurchased debt, and avoid recognizing any gains or losses. Instead, the province would offset the repurchased debt against the original liability in its statement of financial position (i.e., the debt liability is presented net of repurchased debt).

10.2 Use of Rate-Regulated Accounting in Government Business Enterprises

Rate-regulated accounting was developed to recognize the unique nature of entities such as electric utilities whose rates are regulated by an independent regulator under most regulatory frameworks. Rate-regulated accounting is a commonly accepted practice in the US, especially among privately owned, government-regulated utilities. Subject to many prescriptive rules, rate-regulated accounting is used by these privately owned utilities to spread out large capital expenditures—for example, construction of a new power plant—over a longer term based on the reasonable expectation that future government-approved rate increases will allow for the eventual recovery of today's capital outlays. The independent government regulator often allows the privately owned 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.

Rate-regulated accounting is used by two of the province's government-controlled business enterprises, Ontario Power Generation (OPG) and Hydro One, whose rates to customers are approved by the Ontario Energy Board, a government regulator. Rate-regulated accounting is currently allowable under Canadian generally accepted accounting principles, and in turn under Canadian public-sector accounting standards, for government business enterprises.

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 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 because 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 US generally accepted accounting policies (US GAAP) and IFRS were in place as Canada converted to IFRS in 2012. At that time, US 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 US 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—*IFRS 14, Regulatory Deferral Accounts*—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, IFRS 14 provides a first-time adopter of IFRS with relief from having to derecognize their rate-regulated assets and liabilities until the IASB completes its comprehensive review on accounting for such assets and liabilities.

In July 2019, the IASB met to discuss the development of a new accounting model for regulatory assets and liabilities under IFRS. The proposed model's core principle is that an entity with rate-regulated activities applying IFRS recognizes regulatory assets and liabilities, along with the movement between its opening and ending balances as regulatory income and expense. While the model is similar in many ways to US GAAP in its recognition of regulatory assets and liabilities, it differs in some key respects.

The next phase of the IASB's review of rate-regulated accounting is to release an exposure draft of a new standard to replace IFRS 14. The IASB expects to publish the exposure draft in the first quarter of 2020. Until the issuance of the new standard, it is uncertain what financial impact the differences—between the standard and US GAAP—will have on the accounting for regulatory assets and liabilities by government business enterprises.

The use of rate-regulated accounting in government business enterprises, such as OPG and Hydro One, has a significant impact on the government's financial statements. For example, OPG recognized $6.7 billion in net rate-regulated assets as of March 31, 2019. Future reporting under IFRS that does not accommodate rate-regulated accounting in a government business enterprise 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 the development of standards impacting the use of rate-regulated accounting in government business enterprises.

10.3 Public Private Partnerships

In a traditional procurement, governments directly build and operate their infrastructure projects. This means that the government is accountable for all associated risks such as cost overruns, delays or financing risks. Public Private Partnerships (P3) is an alternative finance and procurement model for infrastructure projects that allows public-sector entities to transfer risks of the project to private-sector entities.

Under the P3 model, project sponsors in the public sector—such as provincial ministries, agencies or broader-public-sector entities such as hospitals and colleges— establish the scope and purpose of the project, while construction of the project is financed and carried out by the private sector. Payments for most projects are made either when the projects are substantially completed or at regular agreed-upon intervals. In some cases, the private sector will also be responsible for the maintenance and/or operation of a project for 30 years after its completion.

P3 contracts are complex. Each contract is unique and there are different levels of risks between the public and private sectors based on negotiated arrangements. PSAB issued a Statement of Principle on P3 accounting to provide additional guidance in July 2017, presenting key principles that PSAB expects to include in a future exposure draft that is expected to be released in fall 2019.

We will continue to monitor the development of standards impacting the use of public private partnerships.

11.0 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.

11.1 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 that 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.

To this end, the task force issued three consultation papers: Characteristics of Public Sector Entities (2011), Measuring Financial Performance in Public Sector Financial Statements (2012) and Conceptual Framework Fundamentals and the Reporting Model (2015).

In May 2018, the task force issued a statement of concepts and a statement of principles. The statement of concepts proposed a revised conceptual framework that would replace two existing sections: PS 1000, Financial Statement Concepts and PS 1100, Financial Statement Objectives, while the statement of principles proposed changes to the current financial statement presentation.

PSAB plans to issue exposure drafts for a revised conceptual framework and a revised financial statement presentation standard in 2020.

11.2 Review of International Strategy

In its most recent strategic plan, PSAB signaled its intent to review its approach to International Public Sector Accounting Standards (IPSAS) as set out by the International Public Sector Accounting Standards Board (IPSASB).

In March 2018, PSAB issued a consultation paper to solicit input from stakeholders on the criteria that PSAB should apply in developing its international strategy. PSAB also presented four options for convergence with IPSAS.

In May 2019, PSAB issued a second consultation paper seeking feedback from stakeholders on which international strategy option best meets the Canadian public interest. The four international strategy options presented were:

- **Status quo:** PSAB continues with the existing standard-setting process. PSAB may continue to refer to the work of other standard-setters as desired.
- **Adapt IPSAS principles when developing future standards:** PSAB will continue to develop standards, but future standards must be developed based on IPSAS standards. PSAB will set out guidelines for circumstances in which a departure from IPSAS standards would be permitted.
- **Adapt IPSAS principles except when a departure is permitted:** All IPSAS standards will be adopted on a retroactive basis at a defined transition date. PSAB will develop guidance on when IPSAS might be modified.
- **Adopt IPSAS:** Full adoption of all IPSAS standards. PSAB would not have the ability to modify IPSAS standards for the Canadian environment.

PSAB accepted feedback on these proposals until September 30, 2019. PSAB intends to decide on the future of its international strategy by early 2020.

11.3 Asset Retirement Obligations

In March 2018, PSAB approved a new standard that addresses the reporting of legal obligations associated with the permanent removal of tangible capital assets from service (for example, retirement). The new standard, *PS 3280, Asset Retirement Obligations*, addresses tangible capital assets currently in productive use, such as the decommissioning of a nuclear reactor, as well as tangible capital assets no longer in productive use, such as solid-waste landfill sites.

The new standard is effective for fiscal periods beginning on or after April 1, 2021, although earlier adoption is permitted.

The new section requires that a retirement obligation be recognized in the following circumstances:

- There is a legal obligation to permanently remove retirement costs in relation to a tangible capital asset from service. Legal obligations can arise from legislation, contracts and promissory estoppel (the legal doctrine that stops a person from going back on a promise even if a legal contract does not exist, with the result that the benefit of the promise still goes to the party to whom the promise was made).
- The past transaction giving rise to the liability, such as the acquisition, construction, development or normal use of an asset, has already occurred.
- There is an expectation that future economic benefits will be given up.

- A reasonable estimate can be made. The estimate of the liability includes costs directly attributable to the retirement activities, including the post-retirement operation, maintenance and monitoring of the asset. A present-value technique is often the best method for estimating the liability.

Upon recognition of the liability, the entity would increase the carrying amount of the related tangible capital asset by the same amount as the liability. The cost included in the carrying amount of the tangible capital asset should be allocated to expense in a rational and systematic manner. This could include amortization over the remaining useful life of the related tangible capital asset, or a component thereof.

If the related asset is no longer in productive use, or if the related asset is not recognized for accounting purposes, the related retirement costs would be recorded as an expense.

11.4 Revenue

In June 2018, PSAB approved a new standard on the recognition, measurement and presentation of revenues. The new standard, *PS 3400, Revenue*, addresses revenues that arise in the public sector but fall outside of the scope of *PS 3410, Government Transfers* and *PS 3510, Tax Revenues*.

PS 3400 is effective for fiscal periods beginning on or after April 1, 2022, although earlier adoption is permitted.

Revenues from an exchange transaction are recognized as or when the public-sector entity satisfies the performance obligation. Performance obligations may be satisfied at a point in time or over a period of time, depending on which method best depicts the transfer of goods or services to the payor.

Unilateral revenues are recognized when there is the authority and a past event that gives rise to a claim of economic resources.

11.5 Employment Benefits

In December 2014, PSAB approved an Employment Benefits project to improve the existing PSAS 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*.

In November 2016, PSAB issued an invitation to comment on the deferral of actuarial gains and losses. Governments and other public-sector entities need to make significant assumptions when valuing pension plan obligations and plan assets. Actuarial gains and losses measure the differences between these assumptions and the plans' experience, plus any updates to the assumptions. In the past, it was common accounting practice in Canada to defer such gains and losses over an extended period. However, over the past decade, other accounting frameworks in Canada have moved toward an immediate-recognition approach. The invitation to comment sought input from stakeholders as to whether deferral is still an appropriate choice in the public sector.

In November 2017, PSAB issued an invitation to comment on discount rates. The discount rate is a key economic assumption in measuring employment benefits. A small change in the discount rate can significantly impact the value of the benefit obligation and related expenses. The current guidance is not prescriptive and can result in a wide range of practices. The invitation to comment explored alternative approaches to determining the discount rate, including the market yield of high-quality debt instruments, an approach used by many other standard-setters.

In October 2018, PSAB issued a third invitation to comment addressing non-traditional pension plans. Non-traditional pension plans include joint defined-benefit plans, multiemployer and multiple-employer defined-benefit plans, plans that provide target, rather than guaranteed, benefits, and plans with provisions that share risk between the employer and plan member.

The invitation to comment proposes that a government or other public-sector entity with a non-traditional pension plan recognize its share of the accrued benefit obligation in its financial statements, reflecting the substance of the terms in the plan and taking into consideration relevant factors, facts, events and circumstances.

PSAB accepted feedback from stakeholders until February 1, 2019.

11.6 Financial Instruments—Narrow-Scope Amendments

In January 2019, PSAB issued an exposure draft proposing narrow-scope amendments to *PS 3450, Financial Instruments*.

The most significant proposal in the exposure draft concerns the accounting for debt buybacks, also known as bond repurchase transactions. A government may issue a debt instrument and then purchase this debt through a secondary market. Under the existing guidance, this is accounted for as a debt extinguishment, resulting in the derecognition of both the asset and the liability in the government's financial statements. The exposure draft proposes that such bond repurchase arrangements not be derecognized until the debt instrument is legally cancelled, extinguished or discharged.

PSAB accepted feedback from stakeholders until May 1, 2019.

12.0 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.

12.1 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, 2019*, which pertained to the fiscal year ending March 31, 2019, received Royal Assent on March 26, 2019.

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 2018/19 fiscal year, the Legislature passed two acts allowing interim appropriations—the *Interim Appropriation for 2018-2019 Act, 2017* (Interim Act) and the *Supplementary Interim Appropriation for 2018-2019 Act, 2018* (Supplementary Act). These two acts received Royal Assent on December 14, 2017, and December 6, 2018, respectively, and authorized the government to incur up to $138.8 billion in public-service operating expenditures, $5.8 billion in capital expenditures, and $294.2 million in legislative office expenditures. Both acts were made effective as of April 1, 2018, and provided the government with sufficient authority to allow it to incur expenditures from April 1, 2018, to when the *Supply Act, 2019*, received Royal Assent on March 26, 2019.

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, 2019*, received Royal Assent. The *Supply Act, 2019*, increased authorized public service operating expenditures from $138.8 billion to $140.7 billion and decreased total authorized public-service capital expenditures from $5.8 billion to $5.1 billion, while total authorized expenditures of the legislative offices remain unchanged at $0.3 billion.

12.2 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 ending March 31, 2019.

12.3 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 13 summarizes the total value of Treasury Board Orders issued for the past five fiscal years.

Figure 14 summarizes Treasury Board Orders for the fiscal year ending March 31, 2019, 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. At the time of writing, orders issued for the 2018/19 fiscal year were expected to be published in *The Ontario Gazette* in November 2019. A detailed listing of 2018/19 Treasury Board Orders, showing the amounts authorized and expended, is included in Exhibit 4 of this report.

Figure 13: Total Value of Treasury Board Orders, 2013/14–2017/18 ($ million)
Source of data: Treasury Board

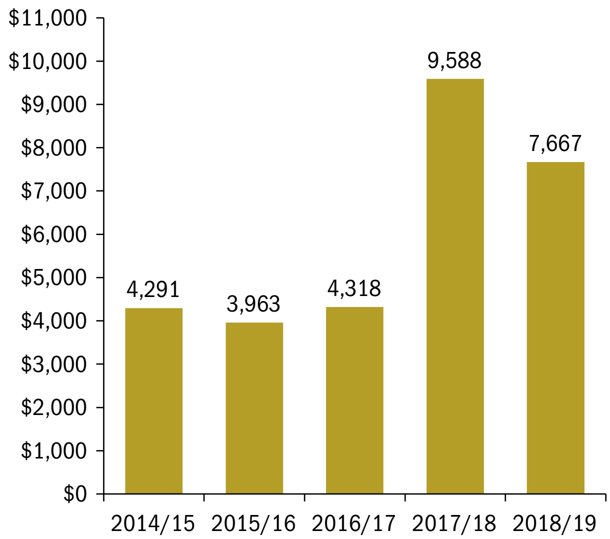


Figure 14: Total Value of Treasury Board Orders by Month Relating to the 2018/19 Fiscal Year
Source of data: Treasury Board

Month of Issue	#	Authorized ($ million)
April 2018–February 2019	28	3,209
March 2019	36	3,510
April 2019	22	285
May 2019	–	–
June 2019	6	663
Total	**92**	**7,667**

12.4 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 15** shows the transfers made within Votes 201 and 202 with respect to the 2018/19 Estimates.

Figure 15: Authorized Transfers Relating to the Office of the Assembly, 2018/19 Fiscal Year
Source of data: Board of Internal Economy

From:		$
201-6	Sergeant at Arms and Precinct Properties	(52,300)
202-2	Office of the Information and Privacy Commissioner	(99,700)
202-3	Office of the Integrity Commissioner	(426,500)
To:		
201-13	Facility Upgrades	52,300
202-1	Environmental Commissioner	99,700
202-4	Office of the Provincial Advocate for Children and Youth	426,500

12.5 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 2018/19 fiscal year, receivables of $608 million due to the Crown from individuals and non-government organizations were written off. (The comparable amount in 2017/18 was $353 million.) The write-offs in the 2018/19 fiscal year related to the following:

- $445.5 million for extinguishing a loan to Old Carco LLC (Chrysler LLC);
- $45.1 million for uncollectible receivables under the Student Support Program ($45.8 million in 2017/18);
- $24.3 million for uncollectible corporate tax ($43.2 million in 2017/18);
- $22.5 million for uncollectible clawback of a conditional grant under the Forest Sector Prosperity Fund;
- $19.2 million for uncollectible employer health tax ($17.1 million in 2017/18);

- $12.7 million for uncollectible receivables under the Ontario Disability Support Program ($34.4 million in 2017/18);
- $11.5 million for uncollectible retail sales tax ($25.4 million in 2017/18); and
- $27.2 million for other tax and non-tax receivables ($37.1 million in 2017/18).

There was no 2018/19 write-off for the 2017/18 $150-million write-off for extinguishing a loan to U.S. Steel Canada (Stelco).

Volume 1 of the 2018/19 Public Accounts summarizes the write-offs 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 write-offs had already been expensed in the government's consolidated financial statements. However, the actual write-off in the accounts required Order-in-Council approval.