CHAPTER FIVE

Public Accounts of the Province

5.00 INTRODUCTION

The Public Accounts for each fiscal year ending March 31 are prepared under the direction of the Minister of Finance as required by the *Ministry of Treasury and Economics Act*. The Act requires the Public Accounts to be delivered to the Lieutenant Governor in Council for presentation to the Assembly not later than the tenth day of the first session held in the following calendar year. However, the Public Accounts are normally tabled each autumn after the end of the fiscal year to which they pertain.

The financial statements of the province, which are included in the Public Accounts, are the responsibility of the Government of Ontario. This responsibility encompasses ensuring the integrity and fairness of the information presented in the statements, including the many amounts which are based on estimates and judgment. The Government is also responsible for ensuring that an established system of control with supporting procedures is maintained to provide assurance that transactions are authorized, assets are safeguarded and proper records are maintained.

The Provincial Auditor audits and expresses an opinion on the financial statements of the province. This opinion is intended to provide reasonable assurance that the financial statements are free of material misstatement. The financial statements, along with the Provincial Auditor's opinion on them, are provided in a separate volume of the Public Accounts. In addition to the financial statements, the Public Accounts include three supplementary volumes.

- Volume 1 contains the Consolidated Revenue Fund schedules and ministry statements. The Consolidated Revenue Fund schedules reflect the financial activities of the government's ministries on a modified cash basis.
- Volume 2 contains the financial statements of significant provincial Crown corporations, boards and commissions which are part of the government's reporting entity and other miscellaneous financial statements.
- Volume 3 contains the details of expenditure and the Ontario Public Service senior salary disclosure.

The Provincial Auditor reviews the information in these three supplementary volumes for consistency with information presented in the financial statements.

THE PROVINCE'S 1998/99 FINANCIAL STATEMENTS

The *Audit Act* requires that in my Annual Report I report on the results of my examination of the province's financial statements as reported in the Public Accounts. I am pleased to report that my Auditor's Report to the Legislative Assembly on the financial statements for the fiscal year ended March 31, 1999 is clear of any qualifications or reservations and reads as follows:

> *To the Legislative Assembly of the Province of Ontario*
>
> *I have audited the statement of financial position of the Province of Ontario as at March 31, 1999 and the statements of revenue, expenditure and accumulated deficit and of cash flows for the year then ended. These financial statements are the responsibility of the Government of Ontario. My responsibility is to express an opinion on these financial statements based on my audit.*
>
> *I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Government, as well as evaluating the overall financial statement presentation.*
>
> *In my opinion, these financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 1999 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles recommended for governments by The Canadian Institute of Chartered Accountants. As required by section 12 of the* Audit Act*, I also report that, in my opinion, these accounting principles have been applied, in all material respects, on a basis consistent with that of the preceding year.*

[signed]

Toronto, Ontario	*Erik Peters, FCA*
August 9, 1999	*Provincial Auditor*

PROVINCE OF ONTARIO ANNUAL REPORT

Since 1996, the Province of Ontario has published an annual report together with the Public Accounts. These annual reports serve to enhance the fiscal accountability of the government to both the Legislative Assembly and the public.

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ACCOUNTING PRINCIPLES RECOMMENDED FOR GOVERNMENTS

The financial statements of the province include the Consolidated Revenue Fund and organizations owned or controlled by the government, and have been prepared in accordance with accounting principles recommended for governments by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) and, where applicable, the *CICA Handbook* for private and public sector corporations in Canada. PSAB recommendations are contained in the CICA's *Public Sector Accounting Handbook*. They represent the consensus of senior government financial officials, legislative auditors and other experts in public sector accounting across Canada on minimum requirements for financial statement accounting and reporting practices for governments.

In applying PSAB standards, the province's accounting policies are similar to those promulgated in the *CICA Handbook* for the private sector with the following two key exceptions:

- Crown agencies that are self-sufficient and sell goods or services to individuals and organizations outside of the government as their principal activity are classified as government business enterprises. Enterprises are accounted for on a modified equity basis as opposed to a line-by-line consolidation as would be the case in the private sector. Examples of such agencies include the Ontario Lottery Corporation and the Liquor Control Board of Ontario. Agencies defined as government service organizations, which are those financially dependent on the government, are fully consolidated. Regardless of the method of inclusion, the net income or deficit of both of these types of agencies is included in the determination of the province's operating results for the year.
- Investments in capital assets by government ministries and government service organizations are recorded as expenditures in the year incurred rather than as assets. They are not amortized to operations over their estimated useful lives as is done in the private sector.

Because of their unique nature, two of the largest organizations of the province, the Workplace Safety & Insurance Board and Ontario Hydro, warrant special mention.

Under the *Workers' Compensation Act*, funding of the Workplace Safety & Insurance Board's liabilities, including its large unfunded workers' benefits liability, is a future financial obligation of private-sector employers and not of the province. The Board has therefore been classified as a trust fund and details are provided in a note to the financial statements.

By virtue of the *Power Corporation Act*, Ontario Hydro's earnings and net assets are neither intended nor available for distribution to the province. Accordingly, Ontario Hydro is not consolidated in the financial statements. However, the province's guarantee of Ontario Hydro's debt, and certain aspects of Ontario Hydro's operations are disclosed in the notes to the financial statements. On April 1, 1999, Ontario Hydro was restructured into five successor entities. Further discussion of this restructuring and its implications for future financial statements follows later in this chapter.

NEW CICA STANDARDS

The CICA attempts to foster improved financial and performance information by continuously improving its existing recommendations and by developing new recommendations to deal with emerging accounting and auditing issues. There are two new standards that warrant discussion.

CASH FLOW STATEMENT

In June of 1998, the CICA's Accounting Standards Board issued a new standard on cash flow statements. The standard calls for cash flows to be classified by operating, investing and financing activities, sets out the components which may be included among cash and cash equivalents, and excludes from the statement investing and financing transactions that do not require the use of cash or cash equivalents. Criteria are also provided for reporting cash flows on a net basis. The Ministry of Finance has implemented the recommendations of this standard in this year's financial statements.

TANGIBLE CAPITAL ASSETS

Currently, Ontario ministries and government service organizations expense the full cost of capital assets in the year of purchase or construction. This differs from the practice followed in the private sector where capital assets are recorded on the balance sheet and amortized to operations over their estimated useful lives. In June 1997, PSAB approved a new set of recommendations setting out rules for the recognition, measurement, amortization and presentation of government capital assets. Among other things, the standard calls for a new statement of tangible capital assets to be included as part of the province's financial statements.

The Ministry of Finance is actively considering the future implementation of these recommendations as part of the new integrated financial information system. However, this project is not expected to be completed in the near future. There is little doubt that instituting a system to properly account for Ontario's significant capital investments represents a challenge. However, we believe that the resulting enhanced financial information would be valuable for both decision-makers and stakeholders.

We continue to look forward to consultation on this matter to assist in ensuring that existence, ownership, auditability and valuation issues regarding these assets are resolved, that value for money is obtained, and that cost-effective business practices, systems and procedures are in place to manage, control and account for these assets.

OTHER RECOMMENDATIONS FOR IMPROVEMENT

Although the audit of the province's financial statements was not designed to identify all weaknesses in internal controls, nor to provide assurances on financial systems and procedures as such, we noted a number of areas during the audit where we believed improvements could be made. While none of these matters affects the fairness of the financial statements of the province, they will be covered, along with accompanying recommendations for improvement, in a management letter to the Ministry of Finance.

LOCAL SERVICES REALIGNMENT

The government, as part of its Local Services Realignment (LSR) initiative, has implemented significant changes in how many government services in Ontario are delivered. Responsibility for a number of programs was transferred through the LSR in whole or in part to municipalities on January 1, 1998. These programs include social assistance, child care, public health, land ambulance, social housing, GO Transit, municipal transit and airports, policing, provincial offences, and court administration as well as the *Provincial Offences Act* revenues. Conversely, the province has reduced residential education taxes and is now responsible for a greater share of provincial education costs. It has also created a Community Reinvestment Fund to address local funding imbalances arising from the LSR reallocations.

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The above changes account for a significant portion of the change in expenditures and revenues for several items in Schedules 1 and 3 of the province's 1998/99 financial statements. The following are the most significant:

- The Annual Report of the province indicates that residential education property taxes have been reduced by approximately $2.5 billion annually, thereby giving municipalities more property tax room to finance their additional program responsibilities. Ministry information indicates that total school board funding from all sources, excluding pension costs, has remained stable over the last two years, totalling $13.1 billion and $12.9 billion respectively. The property tax shortfall to the education sector has been made up via increased provincial operating grants to school boards, which were increased by about $2.9 billion in 1998/99 to $7.5 billion. This accounts for virtually the entire increase in total Ministry of Education and Training expenditures, which were $11.2 billion in 1998/99 versus $8.3 billion in 1997/98.
- The Community Reinvestment Fund provides a means to ensure that fiscally vulnerable communities are not unduly affected by the shift in service responsibilities and that the entire initiative is revenue neutral. Expenditures for this Fund in 1998/99 were $678 million. The Fund is administered by the Ministry of Finance and accounts for most of that Ministry's $814 million expenditure increase for the year.
- The Ministry of Transportation's expenditures dropped by $1,249 million to $1,526 million due primarily to LSR. Last year's expenditures included a one-time $829 million payment to discharge provincial responsibilities associated with the cancellation of the five-year Toronto Transit Commission/City of Toronto Capital Subsidy Agreement. Among this year's changes were reductions of $456 million in municipal transit subsidies.
- The Ministry of Municipal Affairs and Housing's block grants to municipalities dropped by $666 million, accounting for much of the $967 million decrease in expenditure for that ministry.
- Expenditures of the Management Board Secretariat increased by $304 million to $577 million. Of this increase, $180 million related to the new Special Circumstances Fund, established as part of the LSR initiative.
- Expenditures of the Ministry of Agriculture, Food and Rural Affairs dropped by $155 million to $310 million almost entirely because of the transfer of the Farm Tax Rebate program under LSR.

- Fines and Penalties revenue dropped by $124 million to $50 million this year primarily due to the transfer of *Provincial Offences Act* revenue to municipalities.

As a transition measure and to ensure continuity of service, the province continues to deliver many programs subject to LSR on behalf of municipalities, pending full program transfer. During this transition period, municipalities reimburse the province for expenditures made on their behalf. In 1998/99 the province recorded reimbursements of $2.1 billion from municipalities.

ONTARIO HYDRO

SUCCESSOR COMPANIES

Until April 1, 1999, Ontario Hydro was the largest agency in the province. Operating under the authority of the *Power Corporation Act*, Ontario Hydro had broad powers to generate, supply, deliver and regulate electric power at cost throughout Ontario. Ontario Hydro reported to the Legislature through the Minister of Energy, Science and Technology.

In November 1998, the *Energy Competition Act* was enacted to restructure the Ontario electricity industry and introduce competition in the year 2000. Under the Act, Ontario Hydro was restructured effective April 1, 1999 into five successor entities: Ontario Power Generation Inc., Ontario Hydro Services Company Inc., the Ontario Electricity Financial Corporation, Independent Electricity Market Operator and Electrical Safety Authority.

The three largest of Ontario Hydro's successor companies are Ontario Power Generation Inc. (OPG), Ontario Hydro Services Company Inc. (OHSC), and Ontario Electricity Financial Corporation (OEFC). These three entities take on, respectively, Ontario Hydro's generating operations, its transmission and distribution operations, and its debts and residual assets and liabilities. Unlike Ontario Hydro, these three new entities meet the criteria for inclusion in the reporting entity set out by PSAB, in that they are owned and controlled by the province. Accordingly, in the fiscal year ending March 31, 2000, they will be classified as government enterprises, and as such, their annual operating results will form part of the government's annual deficit or surplus and their net assets will be included in the province's statement of financial position.

While OPG and OHSC have considerable assets and have been structured to commence operations with healthy debt/equity ratios, the OEFC commenced operations on April 1, 1999 with an estimated $38.1 billion in total liabilities. Offsetting these obligations are only $17.1 billion in notes receivable from the province ($8.9 billion), OPG ($3.4 billion) and OHSC ($4.8 billion). The remaining $21 billion is effectively the latest estimate of Ontario Hydro's "stranded" debt. We discussed this "stranded" debt at length in previous annual reports.

The government has a long-term plan in place to retire this stranded portion of debt from dedicated revenues. The main source of these revenues will be payments by OPG and OHSC in lieu of property taxes, corporate income taxes and capital taxes. These sources may be supplemented, if necessary, by a Competition Transition Charge that would most likely be paid by all ratepayers as a portion of their electricity bill.

Because of the creation of a dedicated revenue stream, the government intends to account for the $21 billion stranded portion of Ontario Hydro's debt as a deferred charge on OEFC's statement of financial position. This deferred amount will be charged to operations over the recovery period. The details of this accounting have not yet been finalized, but the objective is to minimize the OEFC's financial impact on the province's financial results. Our understanding of the government's rationale for this approach is that, since the retirement of Ontario Hydro's debt through the OEFC is to be done through ratepayer charges rather than from the general tax base, it would be inappropriate for the government's financial statements to be significantly impacted by this initial stranded debt and the revenues earmarked to finance its retirement.

We have accepted this proposed accounting treatment for the OEFC as being allowable under accounting standards for rate-regulated utilities. However, our acceptance of this approach is contingent on being provided with independent assurance annually of the future estimated value of the dedicated revenue streams. If this assurance is not maintained, the deferred amount, or a portion thereof, would need to be written off, and thus treated at that time as an increase in provincial expenditure.

RESTATEMENT OF CERTAIN FINANCIAL STATEMENTS

In our *1998 Annual Report*, we stated that, while Ontario Hydro acknowledged that the charging of $6.4 billion of future expenses to be incurred in the years 1998–2001 to the year 1997 was not in accordance with generally accepted accounting principles for business enterprises, Ontario Hydro and its external auditors had concluded that this accounting treatment was acceptable for enterprises operating in a rate-regulated environment. We expressed our concern that this inclusion of future expenses in 1997 would, in future years, allow Ontario Hydro to significantly inflate its net income.

We understand that Ontario Hydro Services Company Inc., one of the successor companies to Ontario Hydro, has determined with its external auditors that it would be appropriate to restate certain of its financial statements along the lines that we had suggested for Ontario Hydro, that is, expenses are included in operating results of the year in which those expenses are incurred. We believe it would be appropriate for all of Ontario Hydro's successor companies that need to access public capital markets to take action similar to that taken by Ontario Hydro Services Company Inc.

In our view, the ability of Ontario Hydro's successor companies to raise funds through public issues is essential to containing the risk to the Government of Ontario under guarantees provided on existing Ontario Hydro debt amounting to $26.2 billion as at March 31, 1999 and to deal with the recovery of "stranded" debt now recorded in the books of the Ontario Electricity Financial Corporation.

1997 FINANCIAL CONTROL REVIEWS — FOLLOW-UP

In our *1997 Annual Report*, we reported on the results of financial control reviews carried out in nine ministries and central agencies. We found that, overall, ministries had satisfactory controls, systems and procedures to ensure that expenditures were properly authorized, processed and recorded. However, in many of our 1997 reviews, we found that internal control procedures required strengthening in the areas of accountable advances to employees for travel and emergency payments, and payrolls.

During the past year, we carried out follow-ups of these reviews to determine the status of action taken to address the noted control weaknesses/deficiencies. We are pleased to report that, for the most part, the ministries where we made recommendations for strengthening controls over accountable advances and payroll have implemented our recommendations.

However, the former Ministry of Education and Training continued to have difficulties in implementing our recommendations in these two areas. In particular, its accountable advance bank account (authorized balance of $1 million and annual expenditures of $10.4 million) and its payroll accounts had not yet been satisfactorily reconciled. A number of significant amounts had not been investigated to determine their validity and how they should be accounted for. Some of the accountable advance transactions to be investigated dated back several years and amounted to a net unreconciled difference of $465,000. The most recent reconciliations revealed additional differences exceeding $100,000 that had yet to be accounted for.

The net pay clearing account contained over 1,000 unreconciled transactions dating as far back as 1995 and amounting to a net difference of $160,000. As well, the total gross pay for each program area was still not being reconciled to the Ministry's overall total gross pay each pay period. In a sample of pay periods reviewed in 1997, we noted differences of up to $175,000 between the total of all program areas and the ministry total.

Consequently, the risk of unauthorized payments and inaccurate accounting records has remained.

In view of the length of time these weaknesses have persisted, we further recommended that the Ministry's Audit Services Branch quickly investigate:

- ways to make reconciliation procedures more timely and effective;
- opportunities to reduce the volume of payments made from the accountable advance bank account and the volume of transactions entering the net pay clearing account; and
- the propriety of payments that have been made from the accountable advance account.

In its response, the Ministry indicated that it would take the steps necessary to rectify the control weaknesses we had identified and that its Audit Services Branch would monitor the situation and report progress to our Office.

OTHER MATTERS

The Provincial Auditor is required under section 12 of the *Audit Act* to report on any Special Warrants and Treasury Board Orders issued during the year. Additionally, under section 91 of the *Legislative Assembly Act*, the Provincial Auditor is required to report on any transfers of money between Items within the same Vote in the *Estimates* of the Office of the Legislative Assembly.

LEGISLATIVE APPROVAL OF GOVERNMENT EXPENDITURES

The government tables detailed Expenditure Estimates, outlining each ministry's spending proposals on a program-by-program basis, shortly after presenting its Budget. The Standing Committee on Estimates reviews selected ministry Estimates and presents a report to the Legislature with respect to those ministry Estimates that were reviewed. The Estimates of those ministries that are not selected for review are deemed to be passed by the Committee and reported as such to the Legislature. Orders for Concurrence for each of the Estimates reported on by the Committee are debated in the Legislature for a maximum of six hours and then voted on.

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Once the Orders for Concurrence are approved, the Legislature provides the government with legal spending authority by approving the *Supply Act,* which stipulates the amounts that can be spent according to the ministry programs as set out in the Estimate*s*. Once the *Supply Act* is approved, the individual program expenditures are considered Voted Appropriations. However, the *Supply Act, 1998* pertaining to the fiscal year ended March 31, 1999 was not passed by the Legislature.

Instead, pursuant to section 14 of the *Ministry of Treasury and Economics Act*, Order in Council 626/99 was approved on March 24, 1999. This Order in Council authorized the payment, out of the Consolidated Revenue Fund, of all estimated amounts in accordance with the votes and items of the estimates and supplementary estimates concurred in by the Assembly for the fiscal year ending March 31, 1999.

Typically, prior to the passage of the *Supply Act*, the Legislature authorizes payments by means of motions for interim supply. For the 1998/99 fiscal year, the time periods covered by the motions for interim supply and the dates that the motions were agreed to by the Legislature were as follows:

- November 1, 1997 to April 30, 1998 — passed September 23, 1997;
- May 1, 1998 to October 31, 1998 — passed April 27, 1998; and
- November 1, 1998 to April 30, 1999 — passed October 13, 1998.

SPECIAL WARRANTS

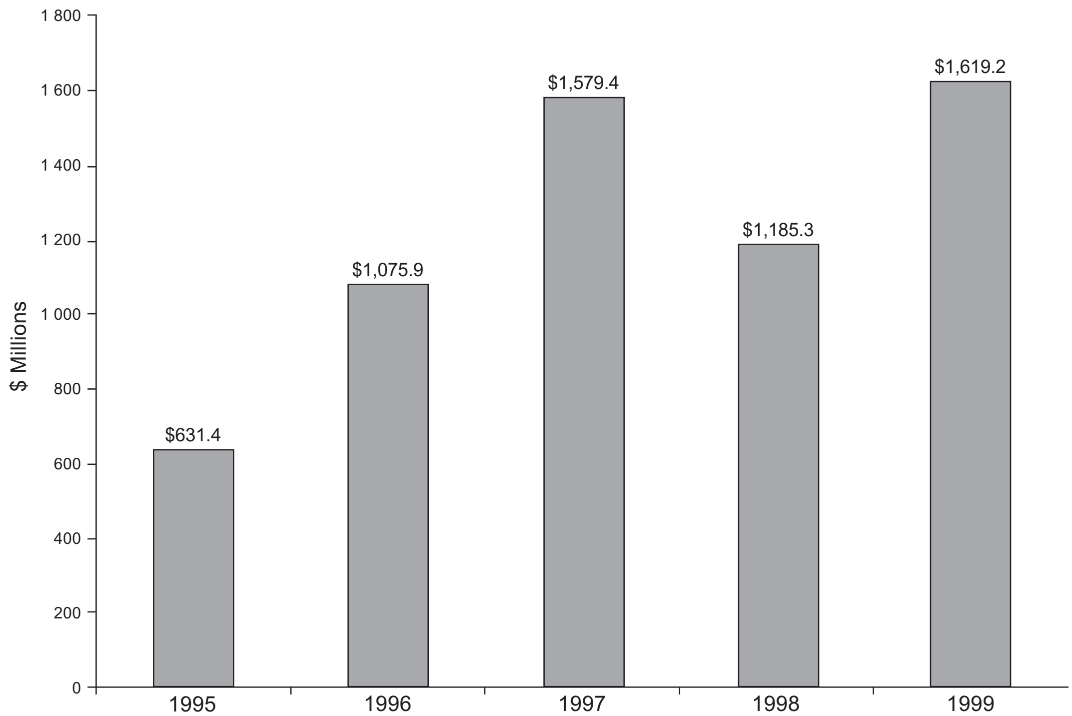
If motions for interim supply cannot be approved because the Legislature is not in session, section 7 of the *Treasury Board Act, 1991* allows the issue of a Special Warrant authorizing the expenditure of money for which there is no appropriation by the Legislature. Special Warrants are authorized by Orders in Council approved by the Lieutenant Governor on the recommendation of the government.

As the three motions of interim supply covered the period from April 1, 1998 to March 31, 1999, no Special Warrants were required during the 1998/99 fiscal year.

TREASURY BOARD ORDERS

Section 8 of the *Treasury Board Act, 1991* allows the Treasury Board to make an order authorizing payments to supplement the amount of any Voted Appropriation that is insufficient to carry out the purpose for which it was made, provided the amount of the increase is offset by a corresponding reduction of expenditures from other Voted Appropriations not fully spent in the fiscal year. The order may be made at any time before the first day of May following the end of the fiscal year in which the supplemented appropriation was made.

The following chart is a summary of the total value of Treasury Board Orders issued for the past five fiscal years:



Treasury Board Orders for the 1998/99 fiscal year summarized by month of issue are as follows:

Month of Issue	Number	Authorized $
May 1998-February 1999	28	706,987,800
March 1999	17	267,839,400
April 1999	11	644,394,600
	56	1,619,221,800

In accordance with a Standing Order of the Legislative Assembly, the preceding Treasury Board Orders are expected to be listed in *The Ontario Gazette* in the fall of 1999, together with explanatory information. A detailed listing of Treasury Board Orders, showing the amounts authorized and expended, is included as Exhibit Four of this Report.

TRANSFERS AUTHORIZED BY THE BOARD OF INTERNAL ECONOMY

When the Board of Internal Economy authorizes the transfer of money from one Item of the Estimates of the Office of the Assembly to another Item within the same Vote, section 91 of the *Legislative Assembly Act* requires the Provincial Auditor to make special mention of the transfer(s) in the Annual Report.

In respect of the *1998/99 Estimates*, the following transfers were made within Vote 201:

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From:	Item 3	Legislative Services	$ 385,000
	Item 5	Administrative Services	9,000
	Item 12	Upgrade Members' Systems	100,000
To:	Item 2	Office of the Clerk	270,000
	Item 4	Legislative Library and Information Systems	100,000
	Item 6	Sergeant at Arms and Building Management	124,000

In addition, within Vote 202, $32,100 was transferred from Item 3 (Office of the Information and Privacy Commissioner) to Item 4 (Office of the Integrity Commissioner).

UNCOLLECTABLE 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 amount due to the Crown which is deemed uncollectable. The losses deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 1998/99 fiscal year, receivables of $193.7 million due to the Crown from individuals and non-government organizations were written off (in 1997/98 the comparable amount was $154.2 million). Page 3-137 of Volume 2 of the *1998/99 Public Accounts of Ontario* provides a listing of these write-offs in total by ministry or Crown agency.

Under the accounting policies followed in the audited financial statements of the province, a provision for doubtful accounts is recorded against the accounts receivable balances. Accordingly, most of the $193.7 million in write-offs had already been provided for in the audited financial statements. However, the actual deletion from the accounts required Order in Council approval.

The major portion of the write-offs related to the following:

- $115.5 million for uncollectable taxes relating to corporation tax receivables;
- $32.9 million for uncollectable taxes relating to tobacco tax receivables;
- $23.8 million for uncollectable taxes relating to retail sales tax receivables; and
- $7 million for uncollectable loans made under the Student Support Programs.