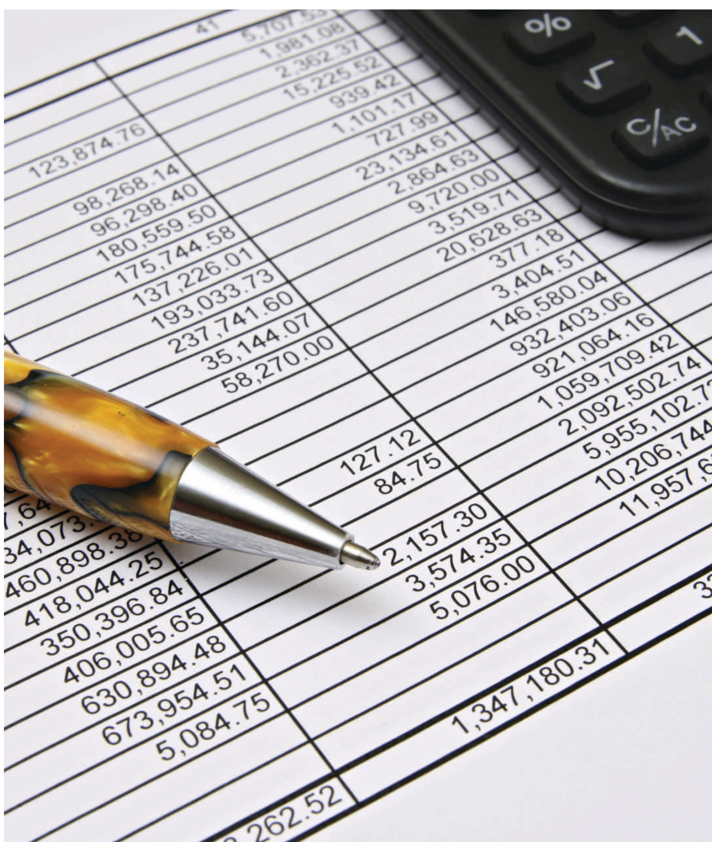
Office of the Auditor General of Ontario

The Auditor General's Review of the 2007 *Pre-Election Report on Ontario's Finances*



Office of the Auditor General of Ontario

To the Honourable Speaker
of the Legislative Assembly

I am pleased to transmit *The Auditor General's Review of the 2007 Pre-Election Report on Ontario's Finances* for submission to the Assembly in accordance with the provisions of subsection 10(3) and section 13 of the *Fiscal Transparency and Accountability Act, 2004*.

Jim McCarter, CA
Auditor General

June 18, 2007

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Synopsis

The government tabled its *2007 Pre-Election Report on Ontario's Finances* on April 23, 2007, in accordance with the requirements of the *Fiscal Transparency and Accountability Act, 2004* (Act). Under the Act, I am responsible for reviewing this report to determine whether it is reasonable and for providing a statement describing the results of my review.

It is important to recognize that, under the Act, a key objective of the pre-election report is to provide information on estimated revenues and expenses—and the resulting surplus or deficit—for the next three fiscal years. The report does not provide information for the 2006/07 fiscal year.

The pre-election report estimates a $400-million deficit for the 2007/08 fiscal year, a surplus of $300 million for the 2008/09 fiscal year, and a surplus of $400 million for the 2009/10 fiscal year. Our work indicated that the estimated revenues and expenses (including the contingency allowance) underlying these amounts, as well as the assumptions supporting them, were reasonable.

However, since these estimates are for future events, actual fiscal results will undoubtedly vary from the estimates. I believe that variances from the estimated results for the next three years are more likely to be favourable than unfavourable (for example, deficits are likely to be less than anticipated and surpluses more). In other words, the estimated results, while reasonable, are more likely to be on the conservative side than on the optimistic side.

More specifically, I believe that two areas in particular could show favourable variances: actual revenues may well be higher than estimated revenues, and actual interest expenses incurred could well be less than estimated.

Assuming that any favourable variances occurring in these two areas are not offset by increased in-year spending or late year-end spending, and taking into consideration the significant general reserve for each year, it is quite possible that the estimated deficit of $400 million for the 2007/08 fiscal year could turn out to be a surplus and the estimated surpluses of $300 million for 2008/09 and $400 million for 2009/10 could approach $1 billion.

My formal review statement is presented on the next page, followed by a narrative providing further details on my review.

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

The Auditor General's Statement on the *2007 Pre-Election Report on Ontario's Finances*

To the Legislative Assembly of the Province of Ontario:

I am required by subsection 10(3) of the *Fiscal Transparency and Accountability Act, 2004* (Act) to review and report on the reasonableness of the government's pre-election report on the province's finances. Accordingly, I am reporting on the consolidated statement of estimated revenues, expenses, and reserve prepared by the Ministry of Finance—for the three fiscal years ending March 31, 2008; March 31, 2009; and March 31, 2010, based on the best information available as at March 16, 2007—contained in the *2007 Pre-Election Report on Ontario's Finances* tabled in the Legislative Assembly of Ontario on April 23, 2007.

I have examined the support provided by the government for its estimates of revenues and expenses and for the assumptions it made in preparing and presenting the estimates. My examination was made in accordance with the standards established for assurance engagements established by the Canadian Institute of Chartered Accountants. I have no responsibility to update this report for events and circumstances occurring after the date of my report.

In my opinion:

- The *2007 Pre-Election Report on Ontario's Finances* complies with the presentation and disclosure standards established by the Canadian Institute of Chartered Accountants for future-oriented financial information and with the requirements of the Act.
- As of the date of this report, the assumptions developed by the Ministry of Finance are consistent with the plans of the government of Ontario, and the estimated revenues and expenses for the three fiscal years reflect the use of such assumptions.
- The assumptions relating to the fiscal years ending March 31, 2008, March 31, 2009, and March 31, 2010, respectively, are suitably supported and provide a reasonable basis for estimating revenues and expenses, keeping in mind that the degree of uncertainty with respect to assumptions increases the further in the future the estimates relate to. Accordingly, assurance with respect to the supportability of the assumptions and their reasonableness in providing a basis for estimating revenues and expenses for the fiscal years ending March 31, 2009 and March 31, 2010 is less certain.

Since the revenue and expense estimates are based on assumptions regarding future events, actual results will vary from the information presented, and the variations may be material. Accordingly, I express no opinion as to whether these estimates will be achieved.

Toronto, Ontario
June 8, 2007

Jim McCarter, CA
Auditor General

Background

The *Fiscal Transparency and Accountability Act, 2004* (Act) established a number of new legislative requirements for both Ontario's fiscal policies and its fiscal plan (see Appendix A for a summary of these requirements). Among the most important of these requirements is the release by the Ministry of Finance (Ministry) of a pre-election report about Ontario's finances, to be reviewed by my Office. The pre-election report is required to include the following:

- the macroeconomic forecasts and assumptions that were used to prepare the fiscal plan and a description of any significant differences from those forecasts and assumptions;
- an estimate of Ontario's revenues and expenses, including estimates of the major components of the revenues and expenses set out in the plan;
- details about the reserve required to provide for unexpected adverse changes in revenues and expenses; and
- information about the ratio of provincial debt to Ontario's gross domestic product.

In requiring that the Ministry release a pre-election report, the Act specifies that the circumstances governing the release may be prescribed by regulation. Since a provincial election is scheduled for October 10, 2007, the government passed Ontario regulation 82/07, requiring that the report be released within 30 days of the 2007 budget motion—the day on which the budget bill is introduced and read for the first time. The government introduced its budget bill on March 22, 2007, and released the *2007 Pre-Election Report on Ontario's Finances* on April 23, 2007.

The Act specifies that the pre-election report should provide an update to the most recent fiscal plan. Since the most recent fiscal plan was contained in the 2007 Budget, brought down just one month prior to the scheduled release of the pre-election report, the government concluded that the fiscal estimates and other information in the report should be consistent with the 2007 Budget. Accordingly, the report, consistent with the Budget, was prepared using the best information available as at March 16, 2007. While certain information relating to events that occurred after the Budget was finalized is provided on page 20 of the report, this information does not significantly affect the fiscal plan. Therefore, the fiscal plan presented in the report is the same as that contained in the 2007 Budget.

Review Scope and Objective

The objective of our review is set out in section 10(3) of the Act, which states, "The Auditor General shall promptly review the pre-election report to determine whether it is reasonable, and shall release a statement describing the results of the review."

Auditors usually review information relating to financial transactions that have already occurred. In contrast, the pre-election report provides the government's estimates of future fiscal results. We therefore sought professional guidance on the review of future-oriented financial information, such as that issued by the Canadian Institute of Chartered Accountants (CICA). We also reviewed the practices in several other jurisdictions where governments prepare future-oriented information that is reviewed by an independent auditor. In addition, we benefited from the advice of our legislative auditor colleagues from other Canadian jurisdictions and consulted with professional staff at the CICA.

The professional guidance issued by the CICA indicates that forecasts based on future-oriented financial information should be based on reasonable, supportable, and internally consistent assumptions that management believes reflect the most probable set of economic conditions and planned courses of action. We discussed this requirement early in the process with Ministry of Finance officials and offered suggestions on the organization and content of the pre-election report. We are pleased to acknowledge that the Ministry was receptive to our input.

Our review consisted of inquiry, analysis, and other procedures, including examination of the government's supporting documentation for the financial estimates and for the key assumptions underlying the financial estimates. We also reviewed the government's results-based planning and budget processes, assessed historical-trend data, and interviewed a number of ministry and other government staff. In addition, because the government develops the estimates for its future taxation revenues using forecasting techniques based on underlying economic data, such as growth in the gross domestic product, inflation, consumer consumption, and wage and salary levels, we engaged an independent expert in the area of econometric forecasting to assist us in our review of these revenue estimates.

Review Results

USEFULNESS OF REPORT

As required by the Act, the pre-election report was designed to inform voters, Ontarians, and political parties of the province's fiscal plan prior to the upcoming provincial election, scheduled for October 10, 2007.

We found the report to be an informative financial document that provides extensive information about Ontario's expected future fiscal situation in a reasonably understandable manner. The report includes details of Ontario's results-based planning process, the processes used to arrive at the province's fiscal plan, how this plan gets approved by the Legislature, and the methods by which prudence and flexibility are built into the plan to guard against unexpected downturns in the economy or other negative events.

The report also provides details of the government's estimated future revenues and expenses by major category, and the assumptions about Ontario's economy that drive these estimates. Discussion about the ways in which specific economic and revenue forecasts and assumptions are sensitive to unforeseen changes can be found throughout the report, and estimates are offered for the impact that changes from the assumptions used would have on specific revenues and expenses. By providing this information, the report enhances the accountability and transparency of the government's fiscal-planning process.

PRUDENT NATURE OF FISCAL PLAN

There are a number of elements of the fiscal plan that reflect a conservative approach to planning—in the report's wording, it is desirable for a fiscal plan to be "constructed prudently—that is, with a margin for caution…" The report points out that basing Ontario's fiscal policy on cautious assumptions is required by the Act.

The principal methods used by the government to ensure the fiscal plan is conservative and prudent, and provides a cushion against unexpected and adverse changes in the provincial outlook, are:

- Revenues are estimated based on assumed growth rates for Ontario's real gross domestic product that are set lower than the average of private-sector forecasts.
- The interest expense on the government's debt is estimated using conservative assumptions about the province's borrowing costs.

- An allowance for contingencies to cover unexpected increases in expenses is included.
- Separate from the contingency allowance, a reserve for each year of the plan is also included.

In combination, these four prudence measures tend to make the fiscal plan conservative in nature. That is, in any given year, we believe the government is more likely to exceed its fiscal targets as set out in the fiscal plan than to fall short of those targets.

Conservative fiscal planning, in addition to being required by the Act, has been driven in part by recommendations made by the Ontario Financial Review Commission (Commission). Specifically, the Commision report to the Minister of Finance tabled in the Legislature in November 1995 recommended the use of prudence as a key element in Ontario's fiscal-planning framework. Conservative fiscal planning has been the norm over the last decade—in nine of the last 10 years, the government exceeded its original fiscal targets and therefore had more funds available at year-end than what was expected.

REVENUE ESTIMATES

Reasonableness of Estimates

Overall, we concluded that the report's revenue estimates and the assumptions underlying them were reasonable, keeping in mind that the level of assurance we can provide becomes less certain as the time period in question moves further into the future.

The major components of government revenues and percentage of total revenues each of them is expected to contribute in the 2007/08 fiscal year are estimated to be as follows:

- taxation revenues—70%;
- transfers from the government of Canada—18%;

- revenues from government enterprises, such as income from the Liquor Control Board of Ontario, the Ontario Lottery Corporation, and Hydro One—4%; and
- other revenues, such as those received for vehicle and driver registration fees and electricity debt retirement charges—8%.

To conclude on the reasonableness of the revenue assumptions and related estimates for the largest component—taxation revenues—we compared the macroeconomic assumptions used by the government with information from a number of external sources. We noted, for example, that members of the Ontario Economic Forecast Council supported the key economic assumptions underlying the province's fiscal plan.

We also obtained a comprehensive report from an independent specialist in econometric forecasting whom we had engaged to help us review the government's estimates for personal income tax, corporations tax, retail sales tax, and the Ontario Health Premium. Collectively, these four sources of taxation revenue are estimated to account for $53.2 billion in provincial revenue for the 2007/08 fiscal year, representing 83% of total expected taxation revenues for that fiscal year.

Our independent specialist assessed the reasonableness of the assumptions used by the government in developing the estimates for these four sources of taxation revenue, the support for those assumptions, and the methodologies used to develop the estimates from those assumptions. He concluded that the estimates, although "cautious," were reasonable and further that the "… methodologies and revenue models used to project revenues are consistent with my knowledge of what is considered best practice among revenue forecasters…"

The primary other sources of taxation revenue are gasoline and fuel tax, tobacco tax, and land transfer tax. The estimates for these taxation revenues were arrived at using tax-forecasting models. We examined the reasonableness of the assumptions used, the support for these assumptions, and the methodologies for applying the forecasting models to arrive at the tax-revenue estimates. We also assessed whether the methodology was used consistently in each of the years covered in the report. As well, we assessed the reasonableness of the Ministry's explanations for the changes in taxation revenues from year to year.

Transfers from the government of Canada include Canada Health Transfers and Canada Social Transfers. Our examination of the estimated revenues from these two transfers primarily consisted of ensuring that the formula and assumptions for estimating Ontario's share of these federal transfers was applied correctly. For the more significant components of other government-of-Canada revenues, we considered the reasonableness of the amounts estimated based on the funding agreements through which these revenues are granted.

Government business enterprises provided the Ministry with their net-income estimates for the next three fiscal years. We compared these estimates with historical trends and conducted additional work for any significant variances from one year to the next.

In assessing the reasonableness of other revenues, for the larger revenue streams—such as vehicle driver and registration fees, electricity debt retirement charges, and power sales—we verified the supporting documentation for the estimates and analyzed changes in revenue amounts from one year to the next for plausibility.

Risk of Actual Revenues Varying from Estimates

As noted previously, the report attempts to provide information on how revenue estimates might be affected if, due to unforeseen changes, actual economic activity differs from what has been assumed. One such unforeseen change has already occurred and, if this change is sustained, it may have a fairly significant effect on revenue estimates. This change relates to the strengthening of the Canadian dollar against the US dollar. The report assumes exchange rates for the 2007/08, 2008/09, and 2009/10 fiscal years of, respectively, 0.86, 0.875, and 0.88 US for $1 CAN. At the time of our review, the Canadian dollar was considerably stronger than it had been in March 2007, and the exchange rate had risen to over 0.94 US for $1 CAN in early June.

The report's sensitivity analysis with respect to the Canadian/US-dollar exchange rate estimates that revenues will decrease between $25 million and $125 million for each sustained one-cent increase over the assumed exchange rate for the full 12-month period. In this regard, our independent specialist concluded:

> The biggest downside risk facing the Ontario economy that has become more likely is the appreciation of the Canadian dollar.… While this is definitely a significant risk, it could quite be offset by other factors, including the prudence built into the budget. It also underlines the wisdom of the practice of building a healthy dose of prudence into the budget-revenue projections.

Even though the actual results relating to certain assumptions, such as that for the Canadian/US dollar exchange rate, may turn out to negatively affect the fiscal plan (resulting in actual revenues being lower than estimated), the flexibility provided by the generally prudent overall economic assumptions and by the annual reserve (of $800 million in 2007/08, $1 billion in 2008/09, and $1.3 billion in 2009/10) should be more than sufficient to offset such effects.

In the last few years, Ontario's revenues have been rising faster than inflation and have been higher than the estimates in the fiscal plan. For example, as Figure 1 illustrates, there is a clear pattern in the revenue estimates used in the 2004 Budget (for which we now have actual results for comparison purposes), where actual revenues for each of the subsequent three years exceeded estimated revenues by a substantial amount. Figure 1 also shows that a large portion of the amount by which actual revenues exceeded estimates related to additional federal transfers (the "Govt. of Canada" column), which can be difficult to accurately predict.

Having examined the 2005 and 2006 budgets and the actual fiscal results that are available for comparison, we continue to see the same pattern. Given this deliberately conservative approach to revenue forecasting, we believe that actual revenues over the next three years could well be higher than the estimates in the report (provided a major unforeseen event, such as the 2003 SARS outbreak, does not occur).

Figure 1: Medium-term Revenue Forecast (2004/05–2006/07), 2004 Budget vs. Actual Revenues

Source of data: Ministry of Finance

	Revenue by Source ($ million)				
	Taxation	Govt. of Canada	Govt. Bus. Enterprises	Other	Total
2004/05					
estimated[1]	53,998	10,798	3,564	6,119	**74,479**
actual	55,975	11,882	3,578	6,406	**77,841**
difference	+1,977	+1,084	+14	+287	**+3,362**
2005/06					
estimated	57,700	11,700	4,100	6,400	**79,900**
actual	59,917	13,251	4,308	6,749	**84,225**
difference	+2,217	+1,551	+208	+349	**+4,325**
2006/07					
estimated	60,600	11,400	4,000	6,500	**82,500**
interim[2]	63,490	14,178	3,988	7,487	**89,143**
difference	+2,890	+2,778	–12	+987	**+6,643**

1. Estimates are from the fiscal plan as reported in the *2005 Annual Report and Consolidated Financial Statements*.
2. Interim results are based on the best information available as of early March 2007.

EXPENSE ESTIMATES

Reasonableness of Estimates

Overall, we concluded that total estimated expenses, including the allowance for contingencies, was reasonable. However, with the exception of estimated interest expenses, we did not note the same conservative approach to the process for estimating future expenses as we did with revenues. For example, the process for estimating the expenses for ongoing ministry programs does not, as a rule, allow a significant amount of flexibility for responding to unforeseen events (for example, growth in expenses beyond normal inflationary pressures). On the other hand, we saw no evidence that program expenses were deliberately underestimated—rather, unlike the case with revenues, there was less flexibility built in.

Another key factor noted was that an integral part of the fiscal-planning process is to provide for a separate contingency allowance for possible increases in program costs not already included in ministry allocations. Therefore, we concluded that, on an overall basis, total estimated expenses were reasonable. In the following sections, we discuss in more detail the government's overall process in estimating anticipated program expenses and provide a brief overview of the work conducted in each of the major expenses categories. We also offer a specific comment on interest expenses, since this is the one expense area where the estimate may well be on the conservative side, and therefore actual interest costs may well be less than estimated.

Process for Estimating Expenses

To fully understand the government's estimates of future expenses, one must understand certain government business practices that are incorporated into the fiscal-planning process that produces these estimates. Specifically:

- To help maintain financial discipline in government operations, the allocations the government approves for the budgets of each ministry tend to be relatively tight. By tight, we mean that the allocations do not build in significant room to cover unexpected increases in service demand or to allow a ministry to respond to other possible, but not yet certain, added expenses. For example, we noted that, often, when ministries requested additional funding to deal with potential uncertainties, particularly those expected to arise two and three years in the future, these requests were not approved. Rather, they were deferred for subsequent in-year discussions or set aside to be dealt with in the next year's results-based planning process. Such uncertainties could include whether higher-than-estimated expenses would be incurred as a result of upcoming renegotiations of collective salary agreements, the provisions in upcoming federal government cost-sharing programs, or possible unexpected growth in the volume of entitlement programs. Approval was generally given only for known, supportable expenditure increases. In addition, in some cases, the government, through the fiscal-plan approval process, encouraged ministries to manage their costs more efficiently by building in expected savings that would reduce the rate at which their costs will grow.
- In all likelihood, unexpected events will occur as the fiscal plan unfolds, creating funding pressures that might require, in at least some ministry programs, the provision of additional funding. To enable the government to address these pressures throughout the year without having to obtain Legislative authority for more funding, the Ministry of Finance analyzes what these pressures might be and assesses the likelihood of these pressures requiring in-year funding. Based on this assessment, as part of the fiscal plan, the government allocates monies into a centrally controlled contingency fund.

> If such in-year pressures actually do materialize, one option available to the government is to reallocate money from this contingency fund to the requesting ministry. In its estimation of future expenses, the government has built in contingency allowances of approximately 1%–1.5% of total expenses each year, amounting to almost $800 million in 2007/08, $1 billion in 2008/09, and $1.5 billion in 2009/10.

This contingency fund must be included in any assessment of the reasonableness of the government's overall expense estimates. Based on our review, we believe the amounts provided in the contingency fund should be adequate to cover off most, if not all, instances where the government's fiscal-planning process may have underestimated ministry expenses.

To summarize, the allocations ministries receive to cover their estimated expenses—while based on realistic assumptions, prior experience, and known future events—do not build in much of a cushion for unexpected events. However, given the built-in contingency allowances, we concluded that the government's expense estimates in the report as a whole were reasonable.

It is important to recognize that, in comparing actual expenses to the budgeted expenses in prior years, the final actual expense amounts reported by ministries reflect the amounts transferred from the contingency fund during the year. Therefore, the actual amounts in a number of cases will be higher than the original, approved estimates due to contingency transfers. The inclusion of contingency-fund transfers in actual reported expenses may not be the only reason why actual expenses exceed estimated expenses. As mentioned earlier, in recent years the government has been experiencing higher-than-expected revenue growth. Its general practice has been to use a significant portion of these revenue surpluses to make late-in-the-year transfer payments that were not built into the fiscal plan. Essentially, unanticipated revenue growth has allowed the government to increase expenditures in priority areas.

Obviously, if the government continues to benefit from unanticipated additional revenues and continues its current practice of increasing year-end expenditures commensurately, actual future expenses will exceed the report's estimates. Similarly, if changes in future government policies result in changes to the current underlying assumptions and spending patterns, actual future expenses will also vary from the report's estimates.

Assessment of Major Expense Components

The major components of government expenses, and the percentage of total expenses each is expected to account for in the 2007/08 fiscal year, are estimated to be as follows:

- transfer payments, including transfers to the broader public sector—76%;
- interest on debt—10%;
- ministry salary-related costs—7%; and
- other expenses—7%.

Transfer payments, being such a large component of total expenses, were a key area of our review of expense estimates. The government has two main types of transfer-payment programs:

- *Entitlement transfer-payment programs*—programs in which the transfer-payment recipient has a legal entitlement to funds if certain eligibility or other conditions are met. Examples include social assistance or disability-support benefits and the Ontario Health Insurance Plan (OHIP) program. The challenge in estimating future expenses associated with entitlement programs is determining how many recipients will have a legal entitlement to the benefits in any future year. In the case of OHIP, for instance, the cost to the government depends on the number of people who access medical services in any given year. In essence, the expenses relating to entitlement programs are somewhat open-ended.

- *Discretionary transfer-payment programs*—programs in which the government has some latitude in determining the ultimate amount to be spent both up front and during the fiscal year. While the estimates of such expenses are typically constrained by the amounts provided in prior years, estimated future amounts can also be adjusted to reflect government policy priorities.

In our review of transfer-payment-expense estimates, we paid greater attention to the larger ones and those for which significant fluctuation from historical trends was more likely. For such estimates, we reviewed the underlying assumptions, considered the entitlement criteria where applicable, assessed the forecasting models used, and analyzed program trends to determine the reasonableness of the projected costs over the next three years.

To assess the reasonableness of the estimated broader-public-sector net fiscal contribution (that is, the net income or loss of public hospitals, school boards, and colleges), we performed trend analysis on the major revenue and expense categories from each sector. We also reviewed the underlying assumptions for growth or decline in each major revenue and expense category for reasonableness, as well as the documentation supporting the assumptions. In addition, we reconciled recorded provincial grant expenses for broader-public-sector entities to the provincial grant revenues the entities recorded.

To assess the reasonableness of the estimates for the remaining expense components (ministry salary-related costs and other expenses), we analyzed trends, obtained explanations for those trends, and examined the support for the estimates that was provided to us.

Interest on the Public Debt

In contrast to the other significant expense areas, interest on the public debt is not based on the costs of delivering services to the public. Rather, it is affected primarily by global market forces. To assess the reasonableness of the estimated expenses for interest on the public debt, we assessed the forecasting methodology used. We also examined supporting documentation and held discussions with Ontario Financing Authority management and staff on assumptions and procedures, and reviewed monthly variance-analysis reports and annual forecasting reports.

While tight budgeting practices are followed in the normal program-expenditure areas—with a risk that at some ministries actual costs may exceed estimated spending and with an allowance for contingencies established to offset this risk—the estimated interest expense for the year has been and continues to be based on conservative assumptions. As indicated in Figure 2, in comparing the estimated interest costs in the 2004 Budget against the actual costs incurred for the last three years, it is evident that actual interest costs incurred were substantially less than the amounts estimated in the budget. We did note, however, that this occurred during a period when interest rates were declining, unlike the current environment of rising interest rates.

Figure 2: Medium-term Interest Expense Forecast (2004/05–2006/07), 2004 Budget vs. Actual Expenses ($ million)

Source of data: Ministry of Finance

	2004/05	2005/06	2006/07
original estimate	10,329	10,800	11,100
actually incurred	9,368	9,019	8,841*
overestimated amount	961	1,781	2,259

* For 2006/07, the "actually incurred" amount is an interim result based on the best information available as of early March 2007.

There has thus been the same pattern of favourable variances with interest expenses as there has been with revenues. These large favourable variances have provided the government with the flexibility to significantly increase spending near the end of a fiscal year and still meet its overall "bottom-line" fiscal targets for the year.

Accountability and Year-end Spending

The historical trend described in the previous sections—in which actual fiscal results for revenues and, to a lesser extent, interest expenses, have been much more favourable than anticipated in the fiscal plan—results in unanticipated surplus funds being available toward the end of a fiscal year. In recent years, the government has made a number of unplanned transfer payments to external organizations late in the fiscal year to utilize these surplus funds to meet government priorities. This has resulted in the government reporting a fiscal deficit or surplus for the year that was closer in line with its original target than would otherwise have been the case.

During our review, we noted that the government has somewhat institutionalized the above practice by identifying candidates for possible year-end transfers earlier in the fiscal year to facilitate the decision-making process if it becomes apparent, late in the year, that there will be surpluses. The combination of such revenue surpluses, the tight timelines involved in these year-end spending decisions, and accounting-standard requirements whereby such transfers can be recorded as an expense only if they meet all of the CICA's expenditure-recognition criteria, has resulted in a significant reduction of the normal accountability controls over these transfers. For example, the transfers bypass the normal, more rigorous ministry results-based planning and approval process.

We have raised concerns regarding the lack of normal accountability controls over these year-end transfer payments in our recent Annual Reports to the Legislature. For example, in last year's Annual Report we noted:

> Again this fiscal year, we continue to have concerns, specifically regarding the relaxing of normal controls—shortly before the fiscal year-end—for unplanned transfers that the government makes to its service-delivery partners.… By way of background, the government normally provides transfers on an as-needed basis rather than in advance of their expenditure needs. For instance, operating transfers are generally provided over the course of the year as such funds are required to finance operations, and capital funds are normally provided on a cost-recovery basis as the transfer-payment recipient completes specific stages of a pre-approved capital project. However, just prior to March 31, 2006, the government entered into a number of transfer-payment arrangements and expensed the amounts involved, thereby reducing the surplus for the year by almost $1.6 billion more than otherwise would have been the case. None of these transfers were originally planned for; that is, none had been included in the government's Budget for the 2005/06 fiscal year, and in many cases, normal accountability and control provisions were reduced or eliminated to ensure the transfers would qualify for immediate expensing.

Another issue that arises with this year-end spending is which organizations should receive the transfer payments. Since ministries would find it difficult to spend significant additional, unanticipated, funding on the direct delivery of services to the public prior to the March-31 fiscal-year end, the additional funds have typically been given to organizations or municipalities. However, if an organization is part of the government, granting it year-end funds would have no net fiscal impact on the government's reported surplus or deficit unless, as with ministries, the funds could be spent prior to March 31. This is because organizations that are part of the government have their financial information consolidated into the province's financial statements; their unspent funds at year-end are reflected in the financial statements as assets and therefore cannot be accounted for as expenses.

Hospitals and school boards, which until recently were outside of the government, were often the primary recipients of year-end spending. However, beginning in the 2005/06 fiscal year, these organizations became part of the government for accounting purposes and their financial information is included in the province's financial statements in accordance with new accounting rules established by the CICA. As a result, in the 2005/06 fiscal year, these organizations in the health and education sectors received very little in the way of year-end funding, while entities such as municipalities, whose accounts are not consolidated into the province's financial statements, received the bulk of the funds. Municipalities, for instance, received $1.4 billion of the almost $1.6 billion in year-end spending last year.

It is not within the purview of the Auditor to question or comment on how or where taxpayers' funds are spent. This is the decision of the government of the day. However, as I have commented in my previous Annual Reports, I am concerned that sound policy and business decisions with respect to such year-end spending are being unduly influenced both by the need to "get the funds out the door" very quickly at year-end and by the fact that CICA accounting rules have such an overriding effect on which recipients can benefit from such significant year-end funding.

Other Matter

STATEMENT OF MINISTRY OF FINANCE RESPONSIBILITY

The pre-election report includes a Statement of Ministry of Finance Responsibility, signed by the Deputy Minister and the Associate Deputy Minister but not by the Assistant Deputy Minister and Controller, who is also a Chartered Accountant. The Statement acknowledges that the Ministry is responsible for preparing the report in compliance with the Act.

The Statement also indicates that the estimates in the report were prepared in accordance with generally accepted accounting principles recommended by the Canadian Institute of Chartered Accountants. Partly for this reason, and also because the Assistant Deputy Minister and Controller has historically signed the Statement of Management Responsibility included in the province's Annual Report and Consolidated Financial Statements, we recommended that the Controller also sign the report. We note as well in this regard that this individual played a key role in co-ordinating the preparation of the report.

After considering our view on the matter, the Ministry provided us with a revised Statement, which now includes the Assistant Deputy Minister and Controller's signature. We have included this revised Statement as Appendix B in our report.

Appendix A

LEGISLATIVE REQUIREMENTS OF THE *FISCAL TRANSPARENCY AND ACCOUNTABILITY ACT, 2004*

The *Fiscal Transparency and Accountability Act, 2004* (Act) requires that the government follow four principles in establishing its fiscal policy:

- *Responsibility*—Ontario's fiscal policy should be based on cautious assumptions.
- *Flexibility*—Ontario's fiscal policy should recognize the need to respond to changing circumstances.
- *Equity*—The impact of Ontario's fiscal policy on different groups within the population and on future generations should be considered.
- *Transparency*—Ontario's fiscal policy should be clearly articulated and information about it should be readily available for inspection by the public without charge.

The Act also requires that the government:

- seek to maintain a prudent ratio of provincial debt to Ontario's gross domestic product;
- plan for a balanced budget unless, as a result of extraordinary circumstances, the Executive Council determines that it is consistent with prudent fiscal policy for the province to incur a deficit for a fiscal year; and
- if planning for a deficit in any fiscal year, develop a recovery plan specifying the manner and the period in which a balanced budget will be achieved.

With respect to the government's fiscal plan, the Act requires that the government:

- annually release a multi-year plan in Budget papers laid before the Assembly;
- ensure that the plan addresses the fiscal year of the Budget and the two succeeding years; and
- include in the plan:
  - Ontario's fiscal policy objectives for the plan period;
  - the macroeconomic forecasts and assumptions used to prepare the Budget;
  - an estimate of Ontario's revenues and expenses for the period of the plan, including estimates of the major components of these revenues and expenses;
  - a reserve to provide for unexpected adverse changes in revenues and expenses;
  - a comprehensive discussion of risks that may have a material impact on the economy or the public sector during the plan period;
  - a description of the intended effects of the plan on the province;
  - information about the ratio of provincial debt to Ontario's gross domestic product; and
  - if a deficit is anticipated, the details of the recovery plan.

Appendix B

Statement of Ministry of Finance Responsibility

This 2007 Pre-Election Report has been prepared by the Ministry of Finance in compliance with the *Fiscal Transparency and Accountability Act, 2004*. The fiscal plan presented in this report is the same as that in the 2007 Ontario Budget.

The Ministry of Finance is responsible for the information contained in this report. The ministry's estimates of revenues and expenses have been developed consistent with the policy decisions of the government and the ministry's best judgments on the projected performance of the Ontario economy, demands for government services and other key fiscal planning assumptions.

In compliance with the requirements of the *Fiscal Transparency and Accountability Act, 2004*, this report includes the following information from the most recent fiscal plan:

- the macroeconomic forecasts and assumptions that were used to prepare the fiscal plan
- an estimate of Ontario's revenues and expenses, including estimates of the major components of the revenues and expenses as set out in the plan
- details of the reserve described in subsection 5 (4) of the Act
- information about the ratio of provincial debt to Ontario's gross domestic product.

The estimates are based on the best information available as at March 16, 2007, the date the 2007 Ontario Budget was finalized. Information related to events that occurred after March 16, 2007 is also provided in this report. This information does not materially impact the financial estimates in the fiscal plan presented in the Budget. Accordingly, the fiscal plan has not been updated in this report.

The financial estimates in this report have been prepared in accordance with generally accepted accounting principles recommended by the Canadian Institute of Chartered Accountants. The accounting policies are consistent with those used by the Ministry of Finance in preparing the Public Accounts of Ontario.

Colin Andersen Deputy Minister	Philip Howell Associate Deputy Minister	Bruce L. Bennett CA Assistant Deputy Minister and Provincial Controller

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