Chapter 5

Public Accounts of the Province

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* (Act). The Public Accounts comprise the province's annual report, including the province's consolidated financial statements, and three supplementary volumes of financial information.

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

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

The province's annual report contains, in addition to the province's consolidated financial statements, a discussion and analysis section that provides additional information regarding the province's financial condition and its fiscal results. As well, this year's annual report for the fiscal year ended March 31, 2007, provides more performance information than in previous annual reports in an effort to describe what the government accomplished in the fiscal year with the taxpayer revenues it raised. Providing such information enhances the fiscal accountability of the government to both the Legislative Assembly and to the public.

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

- Volume 1, which contains the ministry statements and a number of schedules providing details of the province's revenues and expenses, its debts and other liabilities, its loans and investments, and other financial information.
- Volume 2, which contains the audited financial statements of significant provincial Crown corporations, boards, and commissions whose activities are included in the government's consolidated financial statements,

as well as other miscellaneous financial statements.

- Volume 3, which contains detailed schedules of ministry payments to government suppliers, service contractors, and transfer-payment recipients.

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

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

In its 2007 Budget, the government noted that it had been working to improve the timeliness of the province's financial reporting by advancing the dates of the release of its budget and annual report. We are pleased with the Ministry of Finance's efforts in this regard. For example, in contrast with previous years, both the 2006 and 2007 Budget Documents were tabled in advance of the April 1 commencement of the province's fiscal year. As well, the government has over the last few years tabled its annual report and consolidated financial statements about a month earlier than has typically been the case over the last decade. This year, the government released its 2006/07 Annual Report, including its consolidated financial statements, one week earlier than last year. These documents, along with the three supplementary Public Accounts volumes, were released on August 17, 2007.

The Province's 2006/07 Consolidated Financial Statements

The *Auditor General Act* requires that I report annually on the results of my examination of the province's consolidated financial statements. I am pleased to report that my Auditor's Report to the Legislative Assembly on the consolidated financial statements for the year ended March 31, 2007, is clear of any reservations and reads as follows:

> To the Legislative Assembly of the Province of Ontario
>
> I have audited the consolidated statement of financial position of the Province of Ontario as at March 31, 2007, and the consolidated statements of operations, change in net debt, and cash flow for the year then ended. These financial statements are the responsibility of the Government of Ontario. My responsibility is to express an opinion on these financial statements based on my audit.
>
> I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes assessing the accounting principles used and significant estimates made by the Government, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 2007, and the results of its operations, the changes in its net debt, and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

[signed]

	Jim McCarter, CA
Toronto, Ontario	Auditor General
July 23, 2007	Licensed Public Accountant

Enhancing Transparency in Financial Reporting

INTRODUCTION

Enhancing transparency in financial reporting is important to strengthen public accountability for government spending. There have been several government initiatives this year relating to its public accounts and budget-related documents that in our view have enhanced this transparency. In this section, we provide details of these initiatives and discuss areas where we believe further improvements can be made.

AUDITOR GENERAL REVIEW OF THE 2007 PRE-ELECTION REPORT ON ONTARIO'S FINANCES

One of the most significant government initiatives to improve the transparency of government financial reporting was the release this spring of its *2007 Pre-Election Report on Ontario's Finances*.

The *Fiscal Transparency and Accountability Act, 2004* (Act) requires, among other things, that the Minister of Finance release a report on Ontario's finances in advance of a provincial election. The purpose of this report is to provide the public with detailed information to enhance its understanding of the province's estimated future revenues, expenses, and projected surplus or deficit for the next three fiscal years. As a provincial general election had been called for October 10, 2007, the government released its *2007 Pre-Election Report on Ontario's Finances* in April of this year.

As required by the Act, the government's report provided information on:

- the macroeconomic forecasts and assumptions used to prepare the government's fiscal plan;
- an estimate of Ontario's revenues and expenses, including estimates of the major components of the revenues and expenses;
- details of the budget reserve; and,
- the ratio of provincial debt to Ontario's gross domestic product.

The fiscal plan on which the pre-election report was based was set out in the 2007 Ontario Budget. However, the report also provided an update on significant events that happened after the 2007 Ontario Budget figures were finalized.

As required under the Act, I reviewed this report to determine whether it was reasonable and released a report describing the results of my review.

Overall, we concluded that the government's estimated revenues, expenses, and surplus or deficit, as well as the assumptions supporting them, were reasonable, although we cautioned that the level of assurance we could provide became less certain as the forecast data moved further into the future. We further noted that the government's fiscal-planning process incorporated a number of prudence measures that made it more likely that any differences between estimated and actual results were more likely to exceed rather than fall short of fiscal targets.

We found the government's pre-election report to be an informative document that provided extensive information about Ontario's expected fiscal situation over the next three years (2007/08 to 2009/10). It outlined the government's estimated future revenues and expenses by major category, along with the assumptions about Ontario's economy that supported the estimates made. As well, the report described the ways in which specific economic and revenue estimates were sensitive to unforeseen changes, and the estimated impact that changes in these assumptions could have.

REPORTING PERFORMANCE-BASED INFORMATION IN THE ANNUAL REPORT

The March 31, 2007, Annual Report and Consolidated Financial Statements of the province included certain performance-based information as part of its discussion and analysis of 2006/07 program expenses. Specifically, in comparing actual 2006/07 program expenses against those estimated in its budget, the government provided details on some of the activities it had undertaken and the outcomes it had achieved, consistent with guidance from the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants for improving the reporting of government performance information. We believe this represents a good step forward in providing users of the province's annual report and consolidated financial statements with useful information on the nature and purpose of the government's activities. Nevertheless, we believe this performance information can be further improved.

In our view, the government should continue to refine this performance information by indicating more directly the extent to which key performance targets were achieved relative to the targets established at the beginning of the year. The annual report could then be a forum for elaborating on both those key areas where performance targets were met or exceeded, and those where performance may have fallen short, along with the reasons why. We believe this will provide more objective information about government performance. To illustrate with an example: in its 2006/07 Annual Report, the government noted that "almost all children in junior kindergarten to Grade 3 are now in classes of 23 or fewer students." While this information is useful, it would be even more informative if this result was compared against a pre-established publicly stated target for this measure.

ON-LINE ACCESS TO VOLUMES 1, 2, AND 3 OF THE PUBLIC ACCOUNTS

In past years, the Ministry of Finance website did not include postings of all its published public-accounts volumes for public perusal. While the province's annual report, which includes its consolidated financial statements of the province, has historically been provided, the more detailed information in the three supplementary volumes has not. We raised this issue with ministry officials earlier this year and are pleased to report that this issue has now been addressed. Specifically, the Ministry this year publicly posted on its website the March 31, 2007, Annual Report and Consolidated Financial Statements, along with the three supplementary Public Accounts volumes. In addition, it posted this information for the past several years for comparative purposes.

REPORTING OF HEALTH-TRANSFER PAYMENT EXPENDITURES IN THE 2008 ESTIMATES

Local Health Integration Networks (LHINs) are statutory not-for-profit corporations and Crown agencies established under the *Local Health System Integration Act, 2006* (Act). There are 14 LHINs across the province, each responsible for planning, integrating, and funding local health services within its geographic area. While LHINs exercise their authority under the Act, additional responsibilities and performance expectations are set out in Memoranda of Understanding and Accountability Agreements they enter into with the Ministry of Health and Long-Term Care.

Beginning in the 2007/08 fiscal year, LHINs will be responsible for funding and overseeing the operations of approximately 151 public hospitals, 14 Community Care Access Centres, 650 community-support organizations, 400 mental-health or addiction agencies, 54 community health-care centres, and 610 long-term-care homes. LHINs will help determine the allocation of approximately $19 billion in health-care funding to these health-service providers, and will administer some 1,900 service agreements with them.

The government's expenditure estimates, tabled in the Legislature shortly after the Budget, set out the details of the government's operating and capital spending plans for the year. In this regard, we noted that the estimates for the Ministry of Health and Long-Term Care for the 2007/08 fiscal year included transfers to LHINs totalling approximately $19 billion, which they will in turn pay to health-service providers. Unlike past years, however, there is no public information breaking down this planned funding by health-sector component—for example, operations of hospitals, Community Care Access Centres, or local addiction programs.

The government advised that since the respective LHINs will now be responsible for allocating their funding across the various components to meet local health-care needs, a general funding envelope for LHINs in the government's expenditure estimates best reflects their flexibility to allocate funds as they see fit. However, given the significance of total LHIN funding, we believe that the year-end financial reporting should disclose LHIN expenditures by the individual health-care-sector components.

Accountability Relating to Year-end Spending

In our annual reports of prior years, and in our recent reviews of the *2007 Pre-Election Report on Ontario's Finances* and the Ministry of Citizenship and Immigration's year-end grants, I have expressed concerns regarding the government's loosening of the normal accountability controls relating to year-end spending.

The Ministry of Finance has explained that over the course of a year, revenue, expense, and surplus or deficit estimates evolve, and the government's fiscal plan is updated regularly. If and when the government becomes convinced that the fiscal outlook is indeed better than originally estimated, it can further support its public-policy objectives by using these unexpected surpluses to increase transfers to its service-delivery partners, such as municipalities. However, an improved outlook typically cannot be confirmed until close to the end of the fiscal year, which means these new transfers must be completed quickly.

In the 2006/07 fiscal year, revenues exceeded the level estimated in the government's 2006 Budget by $4.7 billion. This allowed the government to make a number of year-end transfers while also allowing it to significantly over-achieve on its original fiscal target. Specifically, just prior to or on March 31, 2007, the government paid out approximately $1.4 billion for a number of year-end initiatives, including:

- $706 million in grants for public-transit projects and roads;
- $210 million in grants to universities to alleviate immediate cost pressures;
- $127 million in grants to municipalities for new affordable housing or to rehabilitate existing affordable housing;
- $70 million in grants to rural and small communities for various infrastructure projects

related to roads, bridges, water, waste water, and community investments;

- $48 million in grants to support social and community infrastructure improvements, including hospices, recreation centres, social-services agencies, and developmental services facilities; and
- $288 million in grants to various other service-delivery partners.

As in past years, none of these transfers had been included in the government's Budget as planned expenditures for the 2006/07 fiscal year. The year-end transfer-payment arrangements were also primarily with organizations outside of government and, as a result, the government expensed almost all of the $1.4 billion of these transfers in the fiscal year ended March 31, 2007. These end-of-year transfers accordingly reduced the surplus for the 2006/07 fiscal year by approximately $1.4 billion more than would otherwise have been the case.

While nearly all of the transfer payments were made to organizations or municipalities with which the province has had long-standing relationships, in the majority of cases, normal accountability and control provisions were reduced or eliminated to ensure that the transfers would qualify for immediate expensing prior to the March 31, 2007, fiscal year-end. Although this issue is of concern, it is important to recognize that it has no impact on our audit opinion on the government's financial statements, since the year-end transfers are accounted for in accordance with generally accepted accounting principles.

One theme that has become apparent is that the current interpretation of the existing accounting standard on transfers is, to a large extent, influencing the lack of accountability and control provisions placed on the year-end grants.

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants has established a task force, of which I am a member, to study accounting and other issues relating to government transfers. Partly as a result of the deliberations of the task force on possible changes to the existing standards, and our concerns in this area, I wrote to the Deputy Minister of Finance on August 15, 2007, to indicate that a reinterpretation of the existing accounting standard should be jointly considered. Specifically, we believe that it may be possible for the government to maintain many of its normal controls and accountability provisions for year-end grants while still meeting the accounting criteria for immediate expensing of these transfers. We are currently working with the Ministry of Finance to ensure that these issues are addressed well in advance of the next fiscal year-end.

While this work may result in enhanced accountability and control provisions for year-end transfers, it will not address our concern, expressed in previous Annual Reports, with the current PSAB accounting standard's requirement that end-of-year transfers to organizations outside of government be recorded as expenses even if they have not yet been used to provide services to the public. These transfers were primarily reflected in past years as health-care and education expenses and, more recently, as municipal-capital and post-secondary-education expenses. But, as mentioned earlier, as of the end of the fiscal year in which the transfers were made, the organizations receiving the transfers had not spent any of the money providing services.

Any enhanced control provisions will also not affect the tendency to make year-end transfers to organizations outside the government financial-reporting entity, such as municipalities—whereas in the past, the bulk of such transfers went to hospitals and school boards, since they were then outside the reporting entity.

While it is not within the purview of the Auditor to question where taxpayer funds are spent, I am concerned when the accounting rules have such an overriding impact on which recipients receive the bulk of any year-end spending.

The Government Reporting Entity

INTRODUCTION

The province's consolidated financial statements include considerably more than just government ministries. In fact, numerous other Crown agencies, Crown corporations, and broader-public-sector organizations, including hospitals, school boards, and colleges, are also included in the government's financial "reporting entity." Inclusion in this reporting entity essentially means that the organization's operating results, and its assets and liabilities, are incorporated along with government ministry operations into the government's financial statements so that these results and balances form part of both the government's annual deficit or surplus, and its accumulated deficit or surplus.

In determining which organizations to include in its reporting entity, the government follows accounting standards recommended by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants. In August 2003, PSAB revised its standard related to the government reporting entity for fiscal years beginning on or after April 1, 2005. Under the revised standard, the decision on whether to include an organization in the government reporting entity is based on one overall consideration: the extent of government control over the organization's activities. In essence, if a government controls an organization, the organization should be included as part of the government reporting entity. The government brought hospitals, school boards, and colleges into its reporting entity under this new standard.

CONSOLIDATION INFORMATION REQUIREMENTS AND TIMELINES

Much of the consolidation work is carried out by the ministries responsible for the new sectors being consolidated—that is, the ministries of Health and Long-Term Care; Education; and Training, Colleges and Universities—under the direction of the Ministry of Finance (Ministry), which has overall responsibility for the preparation of the consolidated financial statements. In our *2006 Annual Report*, we noted a number of instances where improvements to the overall consolidation process were needed to enable the government to continue to meet its goal of improving the timeliness of its financial reporting.

This year, we noted a number of improvements in this area, including:

- improved guidance from the Ministry of Finance that enhanced the clarity of its consolidation-information requirements;
- more accurate and complete information submissions from the organizations in these sectors; and
- an improvement in the account reconciliation and consolidation analysis work conducted by the three ministries responsible for these sectors.

USE OF SPECIFIC REVIEW PROCEDURES

Consolidating Ontario's school boards into the province's consolidated financial statements presents unique challenges for two reasons. First, school boards have a fiscal year-end of August 31, which does not coincide with the province's March 31 fiscal year-end. As well, school boards presently do not record the value of their tangible capital assets in their own financial statements. To address this, school boards have been asked to submit financial information for the same fiscal period as the province, and to provide sufficient information on their capital expenditures and assets to allow the government to include school-board capital in its consolidated financial statements. The auditors of each school board performed specific review procedures on this additional submitted information, and we relied upon their work in conducting our audit of the consolidation process. We encourage the continued use of these review procedures as they provide a timely and cost-effective basis of assurance on the amounts reported by the school boards.

LOOKING AHEAD

Under the new reporting-entity standard, PSAB permits governments to consolidate their broader-public-sector (BPS) organizations on a modified-equity basis of accounting until the 2008/09 fiscal year. Under this treatment, the BPS organizations' assets and liabilities are combined and the resulting net asset position is included as a single line—"net assets of Broader-Public-Sector Organizations"—on the province's consolidated statement of financial position. Likewise, earnings of these sectors are included as a single line in the expenses-by-ministry schedule and combined with sector expenses in the province's Consolidated Statement of Operations.

For all fiscal years that commence on or after April 1, 2008, PSAB standards will require BPS organizations to be fully consolidated. Under full consolidation, the government will have to ensure that the financial activities of BPS organizations are consolidated using the same accounting policies as the province, and that each of their revenue and expense items, including third-party restricted revenues, as well as each of their organization's assets and liabilities, is combined with the corresponding item in the province's consolidated financial statements. One key consequence of this line-by-line approach will be that the $29.7 billion in BPS tangible capital assets and its $12.6 billion of net debt will not be netted against each other. Instead, they will be separately included and reported as part of the province's tangible capital assets and net debt, respectively.

The government has indicated in past budgets that it is not convinced that this line-by-line consolidation of the BPS will provide better transparency and accountability in its financial reporting. Rather, it believes that the current one-line consolidation provides for more understandable reporting to the public and more fairly reflects the greater autonomy that these BPS organizations have compared to the organizations that the province currently fully consolidates. We understand the Ministry has been consulting with PSAB on this matter. As well, the Ministry, along with its colleagues in other jurisdictions, has formed a joint working group with PSAB to explore this and other matters relating to accounting standards.

Notwithstanding, given the existing standard and the April 1, 2008, application date, we believe it would be prudent for the Ministry to conduct a review of the additional information from the BPS that would be required to make line-by-line consolidation possible, ensure conformity with the province's accounting policies, and deal with a number of presentation and disclosure issues that line-by-line consolidation raises.

Stranded Debt of the Electricity Sector

In previous annual reports, we have discussed the electricity sector and the government's efforts to retire the stranded debt of the old Ontario Hydro. In essence, stranded debt refers to the amount of debt and other liabilities of Ontario Hydro that the government concluded could not be serviced in a competitive environment following the restructuring of the electricity sector on April 1, 1999. At the time, the government split the old Ontario Hydro into several new companies, including Ontario Power Generation, Hydro One, and the Ontario Electricity Financial Corporation (OEFC), which is responsible for managing and paying down the debt and certain other liabilities of the former Ontario Hydro.

The government has developed a long-term plan to retire the stranded debt solely from dedicated revenue streams of the electricity sector, including profits earned by the Ontario Power Generation and Hydro One corporations. The plan is updated regularly to reflect current information, and the revision of economic assumptions about Ontario's electricity-sector performance. The government currently estimates that the OEFC's obligations will be defeased in the years between 2012 to 2020. As illustrated in Figure 1, there was a significant reduction in the amount of stranded debt during the 2006/07 fiscal year, the second significant drop in as many years.

Two factors have contributed to the improvements over this two-year period. First, Ontario Power Generation's average revenue limit of 3.8 cents/KwH on about three-quarters of its output, established under the Market Power Mitigation Agreement, was replaced on April 1, 2005, with an average regulated price of 4.5 cents/KwH for its nuclear and large hydroelectric output, and a higher revenue limit of 4.7 cents/KwH on most of its unregulated output. The regulated prices and transitional revenue limit contributed to Ontario Power Generation reporting higher earnings since that time, which, through payments to the government in lieu of provincial taxes, were flowed to the OEFC to service the stranded debt. As well, the profits of Ontario Power Generation and Hydro One combined totalled $914 million for the fiscal year ended March 31, 2007, which was $394 million more than the province's annual financing cost of $520 million for its equity investment in Ontario Power Generation and Hydro One. This $394-million difference exceeded the $327 million in shortfalls from prior years and, accordingly, the net excess of $67 million contributed to the reduction of stranded debt.

Secondly, as we noted in our *2006 Annual Report*, the OEFC started effective January 1, 2005, to receive actual contract prices for power sold under long-term power-purchase contracts entered into by the old Ontario Hydro. Originally, a $4-billion liability had been recorded to reflect the OEFC's commitment under these contracts to purchase power at prices expected to exceed the price that would be received from ratepayers. The government determined, and we agreed, that the most cautious and prudent accounting approach to dealing with this liability was to eliminate it over time. For the 2006/07 fiscal year, the combination of the amortization of this liability and the selling of the power at contract cost resulted in revenue increases of about $400 million, which were applied to reduce the stranded debt.

Figure 1: Electricity Sector Stranded Debt, April 1, 1999–2006/07

Source of data: Ontario Electricity Financial Corporation

Fiscal Year End	($ billion)
at April 1, 1999	19.4
1999/2000	20.0
2000/01	20.0
2001/02	20.1
2002/03	20.2
2003/04	20.6
2004/05	20.4
2005/06	19.3
2006/07	18.3

Accounting for Tangible Capital Assets

GOVERNMENT TANGIBLE CAPITAL ASSETS

In January 2003, the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants revised a 1997 standard relating to the recognition, measurement, amortization, and presentation of tangible capital assets in government financial statements. Until recent years, most governments, including that of Ontario, had charged 100% of the cost of tangible capital assets to operations as an expense in the year such assets were acquired or constructed. The revised standard recommends that governments, in a manner similar to the approach taken in the private sector, record acquired or constructed capital items as assets and amortize their cost to operations over their estimated useful lives.

The government adopted a phased-in approach to these PSAB recommendations. In the 2002/03 fiscal year, it valued and capitalized the province's land holdings, buildings, and transportation infrastructure and accordingly recognized, for the first time, over $13 billion of its net capital investments in its financial statements. This accounts for an estimated 90% or more of the government's total tangible capital assets.

The government has indicated that it intends to complete the valuation of its remaining tangible capital assets, such as its computer systems, vehicles, and equipment, by the 2009/10 fiscal year.

SCHOOL-BOARD TANGIBLE CAPITAL ASSETS

Ontario's school boards and school authorities do not currently capitalize their investments in land, buildings, and other tangible capital assets. Rather, they expense such expenditures immediately. Because the province now capitalizes its investments in land, buildings, and public infrastructure, to ensure consistency upon consolidation of the school boards in the province's consolidated financial statements, the government completed a project during the 2005/06 fiscal year to establish historical cost values for tangible capital assets owned by Ontario's school boards and school authorities. As a result, net tangible capital investments in this sector of $15.7 billion are now reflected in the province's consolidated financial statements. Based on our review of the project and the methodologies employed, we concluded that the values arrived at were reasonable. In future years, the accuracy of the school-board capital-asset information will steadily improve as all capital assets are recorded, the opening book values are amortized, and assets are gradually replaced.

Effective with fiscal years starting January 1, 2009, PSAB standards require that school boards reflect these investments in their own financial statements. For this purpose, we expect that school boards and auditors of school boards may want to rely on the government's valuation exercise in establishing the initial tangible capital-asset values to be included in their financial statements, and on the audit work we performed on these values. Our Office is working with the Ministry of Education to facilitate this process.

New and Proposed Accounting Standards

Accounting standards specify how transactions and other events are recognized, measured, presented, and disclosed in government financial statements. The objective of such standards is to meet the needs of users of financial statements by providing, in a consistent manner, the information needed for accountability and decision-making.

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) is an independent body with the authority to set accounting standards for the public sector in Canada. It also works to serve the public interest by providing guidance for financial and other performance information reported by the public sector. The government of Ontario prepares its consolidated financial statements in accordance with PSAB standards.

The more significant issues PSAB has been dealing with over the last year that may affect the province's consolidated financial statements and reporting practices in future years are briefly outlined in the following sections.

INTRODUCTION TO PUBLIC-SECTOR ACCOUNTING STANDARDS

The CICA now classifies financial reporting entities by one of three major categories: publicly accountable enterprises, non-publicly accountable enterprises (or private enterprises), and not-for-profit organizations. As part of its strategy to harmonize Canadian standards with international standards, the CICA is moving to ensure that financial-reporting standards for publicly accountable enterprises conform to international financial reporting standards (IFRS) issued by the International Accounting Standards Board, and is targeting a changeover date for fiscal periods beginning on or after January 1, 2011, after which the accounting standards in the CICA *Handbook – Accounting* are expected to be identical to IFRS.

PSAB has been assessing the effect of this harmonization strategy on governments, and in this regard has released an Exposure Draft proposing to revise its introduction to public-sector standards. The revised standard would clarify the classification of government business enterprises and government business-type organizations as publicly accountable enterprises, and accordingly require these organizations to prepare their financial statements in accordance with the internationally harmonized standards. The potential impact on government not-for-profit and other organizations is still under review, and PSAB expects to develop a statement of principles for these organizations in the near future.

FINANCIAL INSTRUMENTS

Financial instruments or derivatives, such as foreign-exchange forward contracts, swaps, futures, or options, are primarily used by the government to manage the risks related to debt issued in a foreign currency or at variable interest rates. Currently, PSAB guidance on accounting for derivatives is limited to their application in hedging foreign-currency risk, such as managing the risk associated with holding a debt payable in U.S. dollars. However, governments, including the Ontario government, are increasingly using derivative financial instruments to also manage interest-rate risk. For instance, the province may issue debt at a variable interest rate and, through the subsequent use of financial instruments, effectively convert the variable-rate debt into fixed-interest-rate debt and thereby limit the province's exposure to future interest-rate fluctuations.

In January 2005, the CICA Accounting Standards Board approved three new Handbook sections relating to such activities: *Financial Instruments*, *Comprehensive Income*, and *Hedges*. While these are private-sector standards, and governments are not currently required to apply the income-recognition and measurement provisions they establish, they underscore the need to address these issues from a public-sector perspective.

Accordingly, PSAB created a task force to consider government accounting for financial instruments and the applicability of hedge accounting to governments, and issued a Statement of Principles on Financial Instruments in June 2007. This Statement sets out proposed disclosure requirements and principles for hedge accounting and the recognition and measurement of government financial instruments, including derivatives.

A key issue PSAB is attempting to balance is the need for any new standard on hedge accounting to be both consistent with PSAB's conceptual framework, which sets out overall definitions for assets and liabilities, and to recognize and make allowance for the unique characteristics of governments. In this regard, PSAB proposes that derivatives be measured at fair value. However, in recognition that these revaluations significantly increase the potential for volatility in reported annual results for governments with significant derivative holdings, the proposed hedge-accounting provisions in certain circumstances allow for the revaluation impact on the annual surplus or deficit for the year to be mitigated by recognizing the offsetting impact of hedging transactions.

DISCLOSURE OF INFORMATION ON BUSINESS SEGMENTS

In January 2006, PSAB approved a new standard on segment disclosures requiring governments to define the business segments they are in and to provide a number of supplementary financial disclosures for these segments. These disclosures include the government revenues and expenses attributable to each segment. This project arose because of concerns about the level of aggregation in government summary financial statements, particularly with the recent expansions in the reporting entity under the revised reporting-entity standard, and the reduced level of detail that may be provided when these statements are presented on a fully consolidated basis. The standard applies to fiscal years beginning on or after April 1, 2007.

GOVERNMENT TRANSFERS

As discussed earlier in this chapter, PSAB is working on revising its standard on government transfers to address a number of application and interpretation issues raised by the government community. These issues include the following: the need to resolve an ongoing debate over the appropriate accounting for multi-year funding provided by governments; clarification of the nature and extent of the authorization needed for transfer recognition; clarification of the degree to which stipulations imposed by a transferring government should impact the timing of revenue or expense recognition of a transfer by both transferor and recipient governments; and the appropriate accounting for capital transfers received. Given the billions of dollars that flow annually in such government transfers, the revised standard has the potential to significantly impact the reporting of government financial results.

A variety of views has been expressed on these issues, and PSAB has found it difficult to obtain a consensus on what revisions should be made to the existing standard. One of the key challenges is PSAB's desire for the revised standard to remain consistent with the CICA's underlying conceptual framework while addressing the generally held view that some transfers do give rise to government assets and liabilities.

PSAB issued an Exposure Draft for comment in June 2006 that called for immediate recognition of all transfers as an expense by the transferor and as revenue by the recipient, provided the transfer has been authorized and any eligibility criteria have been met. After reviewing comments received on this Exposure Draft, PSAB issued a Re-Exposure Draft in April 2007 that proposes certain changes to recipient accounting for transfers. Specifically, while the Draft proposes no changes to the accounting for transfers by a transferring government, it does set out certain limited circumstances when a recipient government could defer the recognition of revenue for a transfer it receives. However, given the divergent views on this issue, it may be some time before it is resolved.

PERFORMANCE REPORTING

Governments are complex, and it is important for them to provide clear information to citizens about what they plan to achieve and what they have achieved with the resources entrusted to them. Performance reporting can serve as one means of providing this information.

In June 2006, PSAB completed a project on performance indicators and approved a Statement of Recommended Practice for Public Performance Reporting to promote consistency and comparability in reporting outside of a government's financial statements. It sets out recommended practices for reporting performance information in a public-performance report, addresses non-financial performance information and the linkage of financial and non-financial performance information, and encourages governments to provide information about governance practices. This statement complements an earlier statement on Financial Discussion and Analysis that recognized that a government's financial statements alone cannot be expected to fulfil all the needs of government information users.

PSAB is currently developing recommended practices for identifying and reporting indicators of government financial condition, and plans to issue a Statement of Principles on Indicators of Financial Position in late 2007.

ENVIRONMENTAL LIABILITIES

Canadian accounting standards currently do not specifically address environmental liabilities. In recognition of the need to do so, in June 2006, PSAB approved an environmental liability project. In the current absence of an accounting standard, the governments of Ontario and most other Canadian jurisdictions have not developed specific accounting policies on environmental liabilities. However, the Ontario government appropriately records environmental liabilities when it determines it has little or no discretion to avoid future costs or payments resulting from its environmental responsibilities, and when the amount of this liability can be reasonably estimated.

TAX REVENUE

In March 2006, PSAB approved an Invitation to Comment on Tax Revenues that proposes to adopt the definitions and standards in the International Public Sector Accounting Standards Board's (IPSASB's) Exposure Draft on Revenues from Non-Exchange Transactions (including Taxes and Transfers). This is the first Canadian project running concurrently with an IPSASB project and is an outgrowth of the strategic direction of the CICA to converge Canadian and international accounting standards.

ASSESSMENT OF CAPITAL ASSETS

The objective of this project is to issue a Statement of Recommended Practice that would assist governments in reporting information about major capital assets that would be useful in evaluating the government's financial condition and financial and non-financial performance, and to improve the comparability and reliability of financial and non-financial information about major government assets.

Existing guidance on reporting financial and other information about tangible capital assets in financial reports is limited. A major factor in determining a government's financial ability to maintain existing levels of services is appropriate information about the use and condition of its capital-asset infrastructure. Such information helps users understand the ongoing financial infrastructure costs associated with using it, and the costs associated with the ongoing need for its maintenance, renewal, and replacement.

PSAB approved a Statement of Principles for this project in March 2007 and plans to issue an Exposure Draft in November 2007.

Assistance Provided by the Ontario Internal Audit Division

While the government's Internal Audit Division has historically assisted us in conducting work in certain areas of our public accounts audit, this year, they increased the assistance provided in that area and assisted our staff in our review of the government's *2007 Pre-Election Report on Ontario's Finances*. We requested this assistance because both the Pre-Election Report and our review of the decision-making process with respect to year-end grants funded by the Ministry of Citizenship and Immigration, which was requested by the Premier, had to be completed very quickly during our peak May-July period. I would like to express my appreciation to the Internal Audit Division for their assistance and for the ongoing co-operative working relationship we have had with them over the years.

Other Matter

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

LEGISLATIVE APPROVAL OF GOVERNMENT EXPENDITURES

Shortly after presenting its Budget, the government tables detailed Expenditure Estimates in the Legislature outlining, on a program-by-program basis, each ministry's spending proposals. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and reports the results of this review to the Legislature. The estimates of those ministries that are not selected for review are deemed to be passed by the Committee and are 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 three hours and then voted on.

Once the Orders for Concurrence are approved, the Legislature provides the government with legal spending authority by approving a *Supply Act*, which stipulates the amounts that can be spent by ministry programs, typically those set out in the estimates. Once the *Supply Act* is approved, the individual program expenditures are considered to be Voted Appropriations. The *Supply Act* pertaining to the fiscal year ended March 31, 2007, received Royal Assent on April 18, 2007.

The *Supply Act* is typically not passed until after the commencement of the fiscal year, but ministry programs require interim funding approval prior to its passage. The Legislature authorizes these payments by means of motions for interim supply. For the fiscal year ended March 31, 2007, 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:

- April 1, 2006, to June 30, 2006—passed December 13, 2005;
- July 1, 2006, to December 31, 2006—passed June 21, 2006; and
- January 1, 2007, to March 31, 2007—passed December 4, 2006.

SPECIAL WARRANTS

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

There were no special warrants issued for the fiscal year ended March 31, 2007.

TREASURY BOARD ORDERS

Section 8(1) of the *Treasury Board Act, 1991* allows the Treasury Board to make an order authorizing expenditures to supplement the amount of any Voted Appropriation that is found to be insufficient. The order can be made provided that the amount of the increase is offset by a corresponding reduction of expenditures to be incurred from other Voted Appropriations not fully spent in the fiscal year. The order may be made at any time before the books of the government of Ontario for the fiscal year are closed. The last Treasury Board Order for the fiscal year ended March 31, 2007, was issued on July 30, 2007.

Subsection 5(4) of the *Treasury Board Act, 1991* allows the Treasury Board to delegate to any member of the Executive Council, or to any public servant employed under the *Public Service of Ontario Act, 2006*, any power, duty, or function of the Board, subject to limitations and requirements specified by the Board. In the fiscal year ended March 31, 2007, the Treasury Board, for the first time, delegated its authority for issuing Treasury Board Orders to the Chair of the Treasury Board for inter-ministry transfers and to supplement appropriations from contingency funds in specified circumstances; and to ministers for intra-ministry transfers. For inter-ministry transfers, the increase in an appropriation for one ministry is offset by a reduction in the amount available under an appropriation of another ministry. Intra-ministry transfers involve reducing the amount available under another appropriation within the same ministry. Supplement appropriations are Treasury Board Orders whereby the increase of an appropriation is offset by reducing the amount available under a centrally controlled contingency fund.

Figure 2 summarizes the total value of Treasury Board Orders issued for the past five fiscal years. Figure 3 summarizes Treasury Board Orders for the fiscal year ended March 31, 2007, by month of issue.

According to the Standing Orders of the Legislative Assembly, Treasury Board Orders are to be printed in *The Ontario Gazette*, together with explanatory information. Orders issued for the 2006/07 fiscal year were expected to be published in *The Ontario Gazette* by December 2007. A detailed listing of these Treasury Board Orders, showing the amounts authorized and expended, is included as Exhibit 3 of this report.

Figure 2: Total Value of Treasury Board Orders Issued, 2002/03–2006/07 ($ million)

Source of data: Treasury Board

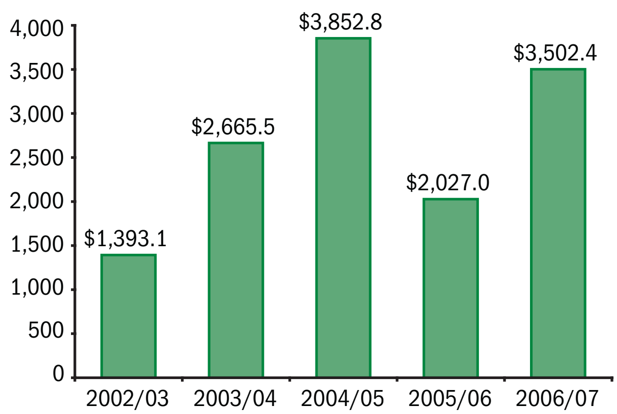

Figure 3: Treasury Board Orders by Month of Issue, 2006/07

Source of data: Treasury Board

Month of Issue	#	Authorized ($)
April 2006–February 2007	102	1,413,853,200
March 2007	53	1,941,415,900
April 2007	14	37,165,200
June 2007	1	10,000,000
July 2007	2	100,000,000
Total	**172**	**3,502,434,300**

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 I make special mention of the transfer in my Annual Report.

With respect to the 2006/07 Estimates, the following transfer was made within Vote 201:

From:	Item 3	Legislative Services	$52,000
To:	Item 2	Office of the Clerk	$52,000

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 amount due to the Crown that is deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2006/07 fiscal year, receivables of $174 million due to the Crown from individuals and non-government organizations were written off ($171 million in 2005/06). The most significant of these write-offs were:

- $76.5 million for uncollectible corporate taxes (2005/06 – $46.7 million);
- $53.7 million for uncollectible retail sales tax (2005/06 – $46.9 million);
- $10.8 million for uncollectible receivables under the Ontario Disability Support Program (2005/06 – $7.9 million);
- $9.5 million for uncollectible employer health taxes (2005/06 – $9.7 million);
- $6.7 million for uncollectible receivables under the Student Support Program (2005/06 – $10.6 million); and
- $6.3 million for uncollectible receivables under the Motor Vehicles Accident Claims Fund (2005/06 – $5.2 million).

Volume 2 of the 2006/07 Public Accounts summarizes these write-offs by ministry. Under the accounting policies followed in preparing the audited financial statements of the province, provisions for doubtful accounts are recorded to offset the estimated uncollectible portion of accounts receivable balances. Accordingly, most of these write-offs had already been expensed in the audited financial statements. However, the actual deletion from the accounts required Order-in-Council approval.