Chapter 2

Public Accounts of the Province

Introduction

Ontario's Public Accounts for each fiscal year ending on March 31 are prepared under the direction of the Minister of Finance, as required by the *Financial Administration Act* (Act in this section). The Public Accounts comprise the province's annual report, including the province's consolidated financial statements, and three supplementary volumes of additional financial information.

The government's responsibility for preparing the consolidated financial statements encompasses ensuring that the information, 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.

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

The province's 2009/10 annual report also contains a Financial Statement Discussion and Analysis section that provides additional information regarding the province's financial condition and fiscal results for the year ended on March 31, 2010, including some details of what the government accomplished in the 2009/10 fiscal year. Providing such information enhances the fiscal accountability of the government to both the Legislative Assembly and the public.

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

- Volume 1—statements from all ministries 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—audited financial statements of significant provincial corporations, boards, and commissions whose activities are included in the province's consolidated financial statements, as well as other miscellaneous financial statements; and
- Volume 3—detailed schedules of ministry payments to vendors and transfer-payment recipients.

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

The Act requires that, except in extraordinary circumstances, the government deliver its annual report to the Lieutenant Governor in Council 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 Legislative Assembly or, if it is not in session, make the information public and then, when the Legislative Assembly resumes sitting, lay it before the Legislative Assembly on or before the 10th day of that session.

This year, the government released the province's 2009/10 Annual Report and Consolidated Financial Statements, along with the three Public Accounts supplementary volumes, on August 23, 2010, meeting the 180-day deadline.

The Province's 2009/10 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 province's consolidated financial statements for the year ended on March 31, 2010, is clear of any qualifications or 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, 2010, and the consolidated statements of operations, change in net debt, change in accumulated deficit, 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. An audit also includes assessing the accounting principles used and significant estimates made by the Government, as well as evaluating the overall financial statement presentation.
>
> In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 2010, and the results of its operations, the change in its net debt, the change in its accumulated deficit, and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.
>
> [signed]
>
> Toronto, Ontario
> July 30, 2010
>
> Jim McCarter, FCA
> Auditor General
> Licensed Public Accountant

Standing Committee on Public Accounts Hearings

The all-party Standing Committee on Public Accounts (Committee) receives the Auditor General's Annual Report, selects topics of interest on which to hold hearings, and reports its observations and recommendations resulting from those hearings to the Legislative Assembly. The Committee's composition, mandate, and activities are explained in more detail in Chapter 6 of this Annual Report.

The Committee selected two sections of our *2009 Annual Report* for review that are directly related to the public accounts of the province: Unfunded Liability of the Workplace Safety and Insurance Board (WSIB); and Unspent Grants.

UNFUNDED LIABILITY OF THE WORKPLACE SAFETY AND INSURANCE BOARD (WSIB)

In Chapter 3 of our *2009 Annual Report*, we expressed concern about the significant recent growth in the WSIB's unfunded liability (which is the measure of the difference between the value of the WSIB's assets and its estimated financial obligations to pay benefits to injured workers). We discussed the factors contributing to this, and the initiatives being undertaken by the WSIB to control the growth of its unfunded liability. In Chapter 2 of our report, we also urged the government to reconsider the exclusion of the WSIB's financial results from the government reporting entity. The exclusion of the WSIB's financial results has been based on its classification as a "trust"; however, given the significant unfunded liability and various other factors, our report questioned whether the WSIB was operating like a true trust. The inclusion of the WSIB in the government's consolidated financial statements would have a significant impact on the government's finances.

The WSIB's audited unfunded liability as of December 31, 2008, totalled $11.5 billion. As of June 30, 2010, it had grown to almost $13 billion, as disclosed in the WSIB's latest available unaudited financial statements, and is projected to rise to $14 billion by 2014.

The Committee held a hearing on the WSIB on February 24, 2010. Presenters included the WSIB's Chair of the Board of Directors, the WSIB's President and Chief Executive Office (CEO), and the Deputy Minister of Labour. The WSIB representatives advised the Committee that they supported the observations we had made in our report, and welcomed the opportunity to discuss with the Committee the actions being taken to address them.

Upon completion of the hearings, the Committee, on October 5, 2010, tabled its report containing its comments and recommendations to the Legislative Assembly. The Committee's 25-page report contained 10 recommendations to both the Minister of Labour and the WSIB, and included reporting back to the Committee on the following:

- whether the WSIB and its stakeholders would support legislative changes requiring full funding over time;
- the results of the WSIB's review of the way it sets premium rates;
- whether the WSIB should have more autonomy in governing its financial affairs;
- the WSIB's progress in drafting a strategy to reduce the unfunded liability; and
- improvements made to the workplace safety experience rating program.

On the basis of recent discussions we had with the President and CEO of the WSIB and the Deputy Minister of Labour and a September 30, 2010, announcement by the WSIB, we believe that the following actions will help address both the Committee's recommendations and our observations:

- Legislative amendments are planned to be introduced which would require that, over time, the WSIB be fully funded.
- Modest increases in the average premium rate for 2011 and 2012, announced in fall 2010, represent a necessary first step in moving toward addressing the unfunded liability over time.
- A major funding review is slated to begin in late 2010, and is to be led by Professor Harry Arthurs, former President of York University. Seeking advice from stakeholders, the review is designed to provide the WSIB with advice on a range of issues, including full funding of the insurance fund and how to achieve it; the design of the employer incentive programs; and the efficiency of the rate-group structure and premium-setting methodology.

As a result of these commitments to address the WSIB's unfunded liability, we have agreed with the government that the WSIB can retain its "trust" classification for the 2010/11 fiscal year. However, we will continue to monitor the progress being made toward addressing the unfunded liability. Should we feel that sufficient progress is not being achieved, we will re-evaluate our position.

UNSPENT GRANTS

Our comments in the *2009 Annual Report* regarding unspent grants related primarily to year-end grants totalling $1.1 billion provided to municipalities in August 2008 under the *Investing in Ontario Act, 2008* (Act in this section) to fund infrastructure investments. These grants were recognized as an expense in the 2007/08 fiscal year but remained largely unspent by municipalities by the end of 2008/09. In addition to the $1.1 billion in transfers to municipalities under the Act, expenditures in 2007/08 included $1.9 billion in year-end grants provided to a number of other transfer-payment recipients. These included grants of $400 million to communities outside of Toronto for roads and bridges, $200 million to universities to maintain and upgrade facilities, and $100 million in transfers for social housing infrastructure. These grants also remained largely unspent by the end of 2008/09.

Although we acknowledged in last year's *Annual Report* that recording these grants as current-year expenses in the province's consolidated financial statements is acceptable under standards set by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants, we expressed concern that this type of accounting conveyed the message that monies had been spent providing programs and services during that fiscal year, when, in reality, few or no services had been provided during that period or no benefits had been received by the public.

In last year's *Annual Report*, we discussed the significant investments that the government had indicated in the 2009 Ontario Budget that it planned to make over the next two years to stimulate the provincial economy. These investments included some $32.5 billion in spending on infrastructure projects. The government indicated that, for the spending to be effective, it wanted it to support quick-start projects. We expressed concern about the risk that some of these funds might not be spent cost-effectively, as well as the potential that many projects might be slow to start and that the actual investments might not be made for several years. In such cases, the "stimulus effects" would not be felt for some time.

Our key recommendation in this regard last year was that public accountability for major year-end transfers and future stimulus funding that is to be spent over a multi-year period would be enhanced if the government publicly reported on the status of the money that it had provided. Such reporting could be presented in the province's annual report to clearly indicate the extent to which the funds transferred have actually been spent on infrastructure investments.

The Standing Committee on Public Accounts held a hearing on unspent grants on April 28, 2010. Presenting before the Committee were senior officials from the Ministry of Finance and the Ministry of Energy and Infrastructure (now the Ministry of Energy and the Ministry of Infrastructure).

The Committee asked the Ministry of Finance how it audits grant recipients to ensure that they adhere to the conditions under which grants were provided. The Ministry indicated that a recipient must report back on a periodic basis how much of the grant has been spent and for what purpose. If the Ministry determines that the money has not been spent, or has not been spent for the intended purpose, the money can be recovered. The Committee also wished to know how much of the infrastructure funding that had been distributed to recipients had actually been spent. Officials at the Ministry of Energy and Infrastructure noted that reporting rules are different for different programs and that under some programs, it is difficult to track, in a timely fashion, money spent by the grant recipients.

However, the Ministry did advise the Committee that it was addressing our recommendation for public reporting for the infrastructure economic stimulus program by disclosing on a website the current status of each approved project.

The Committee tabled its final report containing its comments and recommendations to the Legislative Assembly on October 20, 2010. The report contained the following recommendations to the Ministry of Finance and the Ministry of Infrastructure:

- The Ministry of Infrastructure should report back to the Committee on any measures that are under consideration to expand reporting on its website information related to infrastructure stimulus program spending and project progress.
- The Ministry of Infrastructure should develop a website to track major capital grant programs over $25 million.
- The Ministry of Infrastructure should report back to the Committee on the status of projects funded by stimulus spending that are at risk of not being completed by the time federal and provincial grants end on March 31, 2011, and for which municipalities would be required to solely fund any uncompleted portions.
- The Ministry of Finance should report back to the Committee on whether it supports the principle of pre-flowing grants and recording them as a cost of providing services in the current fiscal year when, in fact, the funds will be spent by the grant recipients in future years.

Update on the Province's Financial Condition

In last year's *Annual Report*, we discussed Ontario's overall "financial health" using a core set of indicators, common to all governments, as recommended by the Canadian Institute of Chartered Accountants' Public Sector Accounting Board. Using information from previous consolidated financial statements and government projections in the 2009 Ontario Budget, we outlined the sustainability, flexibility, and vulnerability of government finances to large, looming deficits and debt increases. In this context, these terms are defined as follows:

- *Sustainability*—the government's continuing ability to manage its financial and program commitments and debt burden;
- *Flexibility*—the government's continuing ability to borrow in the future or to increase taxes or government fees to meet financial obligations; and
- *Vulnerability*—the government's reliance on funding sources that are beyond its control and influence, such as revenue transfers from other levels of government.

Our analysis last year indicated that the province's financial condition had generally been improving since the 2001/02 fiscal year. However, beginning in 2009, this trend would reverse over the next few years because of the large deficits and increases in debt that the government had projected due to the recent economic downturn.

The province reported a deficit of $19.3 billion in its 2009/10 consolidated financial statements. The province's debt, which includes all provincial borrowings, had risen by nearly 20%, to $212 billion from $176.9 billion a year earlier. In the 2009 Ontario Budget, the government set out its plan to eliminate the deficit by the 2015/16 fiscal year. In the 2010 Ontario Budget, the government revised its deficit projections and indicated that it now plans to eliminate the deficit by 2017/18. The following analysis updates the information presented last year on the province's financial condition using the government's latest budget projections.

ONTARIO'S REVISED PLAN TO ELIMINATE THE DEFICIT

Deficits occur when revenues the government collects are insufficient to cover spending. The

government must borrow to finance its deficits, to replace maturing debt, and to fund its investments in built or acquired capital assets. The *Fiscal Transparency and Accountability Act, 2004* requires the government, when it projects a deficit, to outline its fiscal plan to balance the budget. Figure 1 provides a summary of the latest projections outlined in the 2010 Ontario Budget of future deficits in this recovery plan.

The combined annual deficits for the fiscal years 2010/11 to 2016/17 now total nearly $90 billion. The yearly annual deficits, combined with borrowings to finance maturing debt and the government's infrastructure spending, will significantly increase Ontario's net debt—liabilities minus financial assets—over the next few years. As Figure 2 shows, Ontario's net debt is now projected to grow from $193 billion in 2009/10 to $267 billion in 2012/13—an increase of $74 billion, or 38%, from the current level.

ONTARIO'S FINANCIAL CONDITION INDICATORS

Based on the most recent deficit projections in the government's latest fiscal plan, there are noteworthy changes to the "financial health" indicators

Figure 1: Provincial Deficit Elimination Plan, 2010/11–2017/18 ($ billion)

Source of data: 2010 Ontario Budget

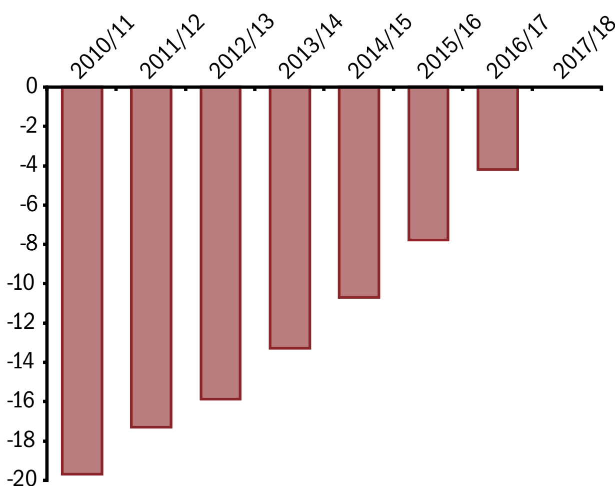
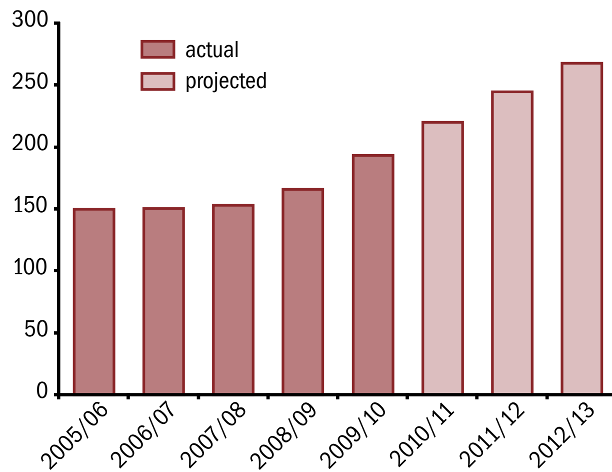


Figure 2: Provincial Net Debt, 2005/06–2012/13 ($ billion)

Source of data: 2010 Ontario Budget



we examined last year. Our update on the sustainability, flexibility, and vulnerability of government finances is as follows.

Sustainability

Sustainability is the degree to which a government can maintain its existing financial obligations, with respect both to its service commitments to the public and to its financial commitments to creditors, employees, and others, without increasing the debt or tax burden. Sustainability addresses the government's ability to manage its financial and program commitments and debt burden. Two key sustainability indicators are as follows.

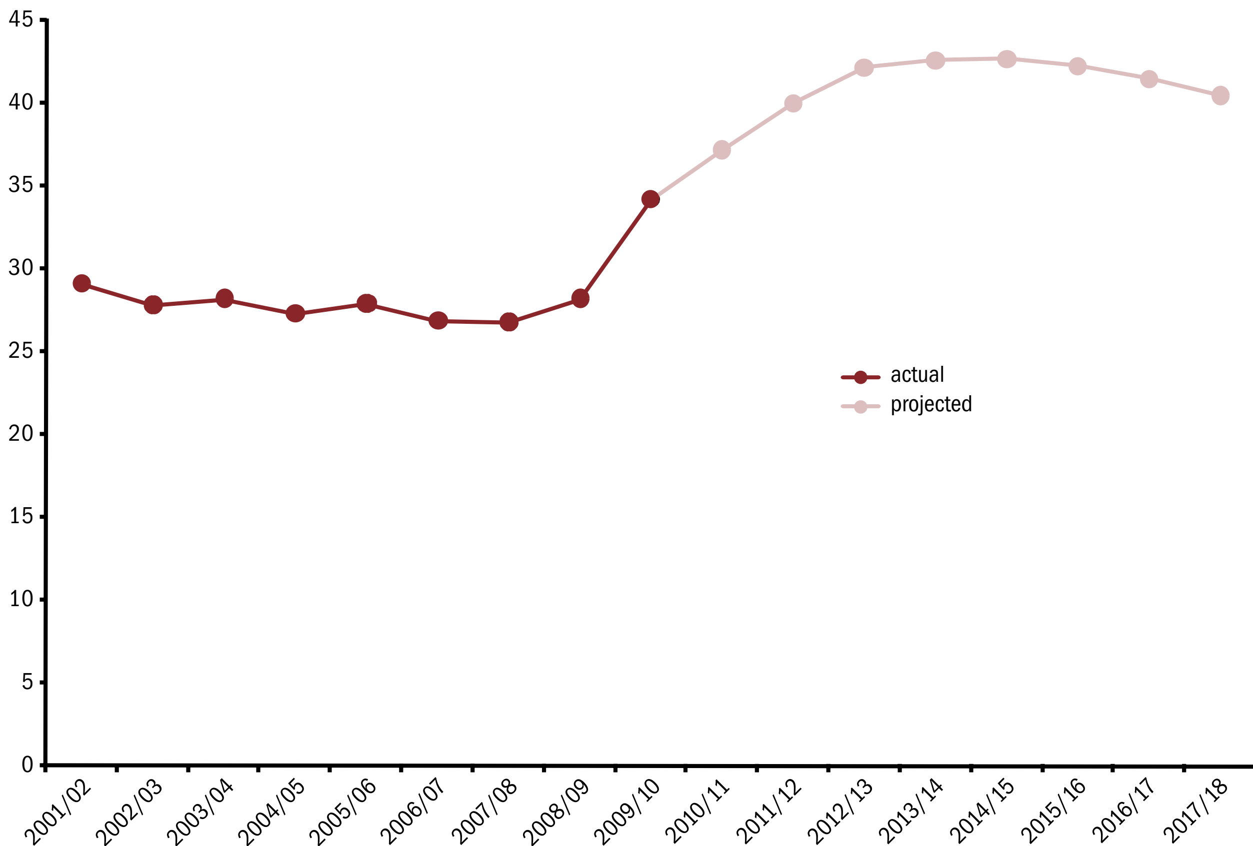
Ratio of Net Debt to GDP

The ratio of net debt to Gross Domestic Product (GDP) measures the relationship between a government's obligations and its capacity to raise funds to meet them. In other words, it considers the debt that must be repaid relative to the value of the output of Ontario's economy. When the ratio is rising, it means that the government's net debt is growing at a faster rate than the provincial economy.

Figure 3 shows that the province's net-debt-to-GDP ratio had been relatively stable from the

Figure 3: Ratio of Provincial Net Debt to Gross Domestic Product (GDP), 2001/02–2017/08 (%)

Source of data: 2010 Ontario Budget



2001/02 fiscal year through 2007/08 at slightly less than 30% but has begun to increase and is likely to continue to do so well into the coming decade. This projected increase reflects the government's decision to significantly increase its borrowings in order to fund its deficits and infrastructure investments. Only in 2015/16 is the net-debt-to-GDP ratio projected to begin falling, after reaching a high of 42% in 2014/15.

Ratio of Net Debt to Total Annual Revenues

The ratio of net debt to total annual revenues is an indicator of how much time would be needed to eliminate the province's debt if all revenues could be devoted to it. For instance, a ratio of 250% indicates that it would take two-and-a-half years to eliminate the provincial debt if all revenues were devoted to it. As shown in Figure 4, this ratio declined from about 190% in 2003/04 to about 150% in 2007/08, reflecting the fact that, while the province's net debt remained essentially the same, annual provincial revenues were increasing. However, the ratio increased in 2008/09 and 2009/10 and is projected to continue to increase for the next two years, reaching a high of almost 240% by the end of 2012/13.

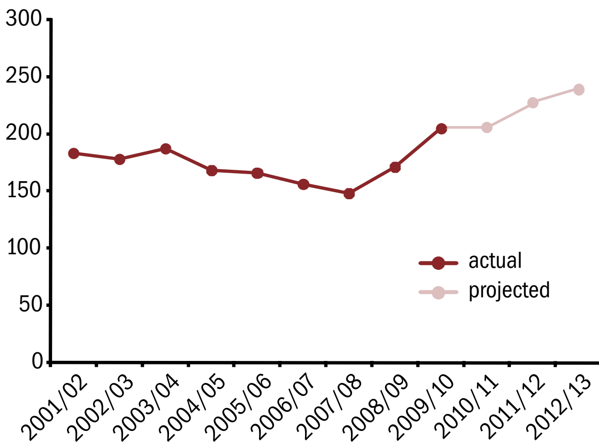
Flexibility

Flexibility measures the degree to which a government can change its debt or tax burden to meet existing financial obligations. Current borrowings reduce the government's future ability to respond to adverse economic circumstances. Similarly, increasing taxes or government fees may reduce the government's ability to levy such measures in the future as the government approaches the limits that the public is willing and able to bear.

We examine two indicators for this measurement.

Figure 4: Ratio of Provincial Net Debt to Total Annual Revenues, 2001/02–2012/13 (%)

Source of data: 2010 Ontario Budget



Ratio of Interest Expense to Revenues

Increases in the cost of servicing total debt, or interest expense, can directly affect the quantity and quality of programs and services that government can provide. The higher the proportion of government revenues needed to pay interest costs arising from past borrowing, the less will be available for program spending.

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

As Figure 5 shows, the province's interest-expense-to-total-revenues ratio has been decreasing steadily over the past decade, even as provincial net debt has been increasing due to lower interest rates in recent years. Based on the latest projections in the 2010 Ontario Budget, the ratio is expected to gradually increase to almost 12% by 2015/16 from its low of 8.6% in 2007/08. This means that the government expects to spend nearly one out of every eight dollars of revenue collected on servicing the province's net debt by 2015/16. In 2007/08, only one out of every 12 dollars of revenue collected was required in order to service the province's net debt.

Interest rates have been relatively low and falling over the past several years, recently approaching record low levels. This has enabled the government to keep interest expenses relatively consistent even as its total borrowing has been increasing. However, if this indicator continues to increase because of increased borrowing or higher interest rates, the government will have less flexibility to spend money on programs providing public services because a higher proportion of government revenues will be devoted to paying interest costs on the province's debt.

Ratio of Own-source Revenues to GDP

The ratio of own-source revenues—primarily tax and fee revenues—to GDP shows the extent to which a government is taking income out of the economy, through either taxation or user charges. If the indicator is increasing, the government may have less room to raise taxes or increase fees. From the 2005/06 fiscal year to projections for 2012/13, the government's own-source revenue as a percentage of GDP is projected to hold steady. On the basis of projections in the 2010 Ontario Budget, it is estimated to range between 13.7% and 14.7%, and average 14.1%, over this eight-year period.

Vulnerability

Vulnerability refers to the degree to which a government becomes dependent on outside revenue sources or is exposed to risks that could impair its ability to meet existing obligations, with respect both to its service commitments to the public and to its financial commitments to creditors, employees, and others. It is an important aspect of financial condition because it provides insight into a government's reliance on funding sources that are beyond its control and influence, such as revenue transfers from other levels of government.

We examine the following indicator for this measurement.

Ratio of Federal Government Transfers to Total Revenues

Although detailed revenue projections have not been published beyond the 2012/13 fiscal year, the proportion of revenue that the Ontario government receives from the government of Canada has been rising. Based on the government's most recent revenue projections since 2005/06 when it was 14.7%, it is projected to peak at 22.2% in 2010/11. This peak is largely the result of federal–provincial stimulus funding arrangements that are scheduled to end in 2010/11. By 2012/13, the proportion of revenue that the Ontario government receives from the government of Canada is expected to decrease to 18.3%. The federal government is facing fiscal challenges of its own, and any unforeseen future reductions in federal transfers could result in the province having to issue more debt or raise taxes or fees if it wishes to maintain its projected spending plans.

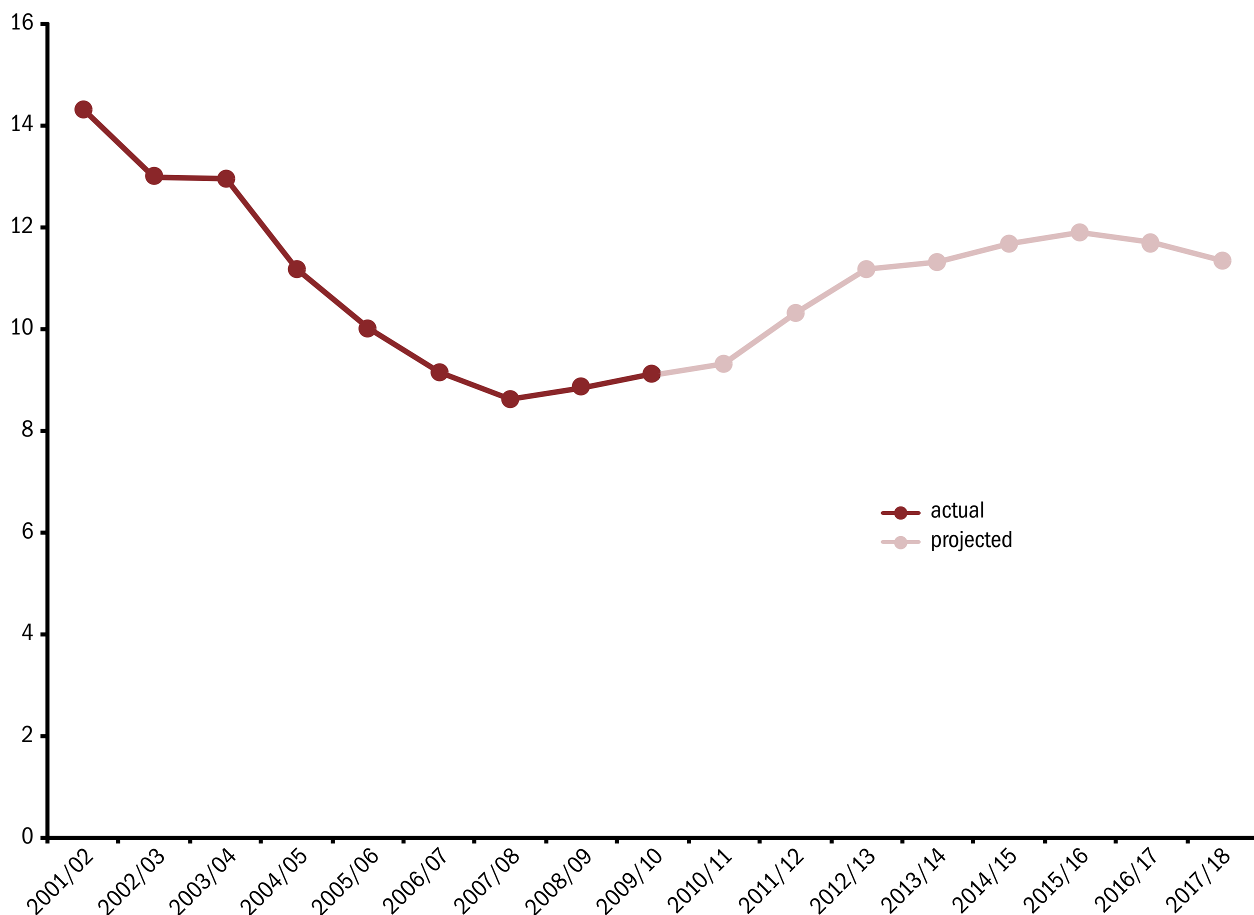
REVIEW OF THE 2011 PRE-ELECTION REPORT

The *Fiscal Transparency and Accountability Act, 2004* (Act in this section) established the requirement that the Ministry of Finance, in the year of an election, release a pre-election report about Ontario's finances to be reviewed by my Office. The pre-election report is to provide an update on the government's most recent fiscal plan as reported in its latest budget, including:

- 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;

Figure 5: Ratio of Provincial Interest Expense to Total Revenues, 2001/02–2017/18 (%)

Source of data: 2010 Ontario Budget



- 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.

The Act also 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."

The government released its first pre-election report, which contained the results of our review, in June 2007. Because the fiscal plan contained in the 2007 Ontario Budget was brought down just one month prior to the 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 Ontario Budget.

Because an election is scheduled for October 2011, the government is expected to release its second pre-election report after the release of the 2011 Ontario Budget. My Office will once again promptly review the report in accordance with the Act.

Update on the Province's Stranded Debt

The term "stranded debt" refers to the debt and other liabilities of the former Ontario Hydro that could not be serviced in a competitive environment following the restructuring of the electricity sector on April 1, 1999.

On that date, the government split Ontario Hydro into several new companies, including Hydro One, Ontario Power Generation (OPG), and the Ontario Electricity Financial Corporation (OEFC). OEFC's responsibilities include managing and paying down the debt and other liabilities of the old Ontario Hydro.

OEFC is implementing the government's long-term plan to retire the former Ontario Hydro's stranded debt primarily from revenue within the electricity sector, including OPG and Hydro One, and from a debt-retirement charge (DRC) paid by ratepayers.

The plan, which includes future cash flows and provides a retirement date, is updated annually on the basis of current information and assumptions. The plan considers the stranded debt to be retired at the point when OEFC's liabilities are fully offset by its assets. The current version estimates that the stranded debt will be retired sometime between 2015 and 2018.

Initially, little progress was made in reducing the stranded debt. However, over the last few years, it has been steadily decreasing, as shown in Figure 6.

Since the 2004/05 fiscal year, a $2.1 billion reduction to the stranded debt has resulted from legislated reforms that allowed OEFC to recover from ratepayers the full cost of its power purchase contracts with independent energy producers. The reduction in the stranded debt during the 2009/10 fiscal year was largely the result of improved net

Figure 6: Electricity-sector Stranded Debt, 1999/2000–2009/10 ($ billion)

Source of data: 2010 Ontario Budget

Fiscal Year End	
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
2007/08	17.2
2008/09	16.2
2009/10	14.8

income from OPG. Most of this improvement was attributable to income earned on the $10.3 billion in investments from the Used Fuel and Decommissioning Segregated Funds (known as the "nuclear funds"), as opposed to earnings from OPG's electricity-generating operations, which were lower compared to the 2008/09 fiscal year. (The nuclear funds are funded by both OPG and the province to ensure that the necessary funds are available to cover the future costs of decommissioning nuclear plants and for nuclear waste fuel management.)
Obviously, any forward-looking financial plan is subject to uncertainty because it is based on projected assumptions and hypotheses, and actual results can and will fluctuate. The uncertainties in this plan that especially concern us pertain to the future financial performance of OPG and its related contributions to reducing the stranded debt. Specifically:

- *Public and political pressure to keep electricity-rate increases low:* The model assumes that OPG's power rates will be sufficient to cover costs and provide a reasonable rate of return. OPG recently decided to delay seeking an increase in its rates for the 70% of its output regulated by the Ontario Energy Board. Because only income over a certain threshold amount can be applied to reduce stranded debt, the inability to fully recover costs in a timely manner has an impact on annual operating results and the paying down of the stranded debt.
- *Cost overruns for electricity generation projects:* OPG continually has large capital projects under way relating to nuclear and other generation facilities. For instance, the Niagara Tunnel Project, announced in September 2005, was to have cost OPG $895 million to build and was to have opened in late 2009. The project cost is now estimated at $1.6 billion, with start-up delayed to December 2013. The model assumes that OPG will be allowed by its regulator (the Ontario Energy Board) to pass on cost overruns of capital projects to its ratepayers.
- *Volatility in the investment returns on the nuclear funds:* Canadian accounting standards followed by OPG require that unrealized investment gains and losses be reflected in OPG's net income. Such unrealized changes have been highly volatile in recent years, as illustrated by OPG's 2009 nuclear funds income of $683 million—a $776 million improvement over the $93 million loss in 2008. Recently proposed changes to public-sector accounting standards may minimize some of this volatility in the future.

In our view, the uncertainties associated with some of the plan's other key revenue sources that contribute to paying down the stranded debt are not as significant or as volatile as those for OPG. For example, the revenue from the Debt Retirement Charge is based on 0.7 cents/kWh and is charged on all electricity consumed in Ontario. Electricity demand on average is unlikely to be lower in future years. In the case of Hydro One, because most of its operations relate to transmission and distribution, its operating results tend to be more predictable.

Future Public Accounts Issues

PUBLIC SECTOR ACCOUNTING BOARD'S STANDARD-SETTING PROCESS

Accounting standards specify how transactions are to be recognized, measured, and disclosed in the financial statements of private- or public-sector entities. In order to be authoritative, standards for financial accounting and reporting should be developed through an organized, open, and transparent process by a recognized standard-setting body.

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants

(CICA) has the authority to set accounting standards for the public sector. PSAB standards represent generally accepted accounting principles (GAAP) for governments in Canada and are the primary source for public-sector accounting guidance in Canada.

A key element in PSAB's setting of standards is that it follows an open process in the development and issuance of its accounting standards—otherwise known as "due process." PSAB emphasizes due process in order to ensure that the views of those who have an interest in public-sector accounting and financial reporting are heard and considered. Due process is critical in maintaining the objectivity of the accounting-standard-setting process. In developing an accounting standard, PSAB typically follows a five-step process:

1. conduct basic research;
2. approve a project proposal;
3. set a statement of principles and issue it to a designated group of associates for initial feedback;
4. issue one or more public exposure drafts available for public comments by any interested individual or organization; and
5. approve a final standard.

Another element of the process of setting accounting standards is the requirement that any new standard be consistent with the CICA's overall conceptual framework. The CICA's conceptual framework consists of interrelated objectives and fundamentals that support the development of consistent accounting standards. As new accounting and financial reporting issues arise, accounting-standard-setting bodies such as PSAB use this framework to ensure that any proposed standard is consistent with the CICA's overall financial reporting model.

PSAB has been under significant pressure from various stakeholders to reconsider some recently proposed changes in accounting standards. Governments, for instance, want to ensure that the proposed changes do not adversely affect their financial reporting, budgets, and fiscal policy decisions. In setting standards, PSAB must ensure that new accounting standards or changes to existing accounting standards follow due process and are consistent with its conceptual framework (which is based on the CICA's overall conceptual framework) and, most importantly, result in financial statements that fairly reflect the results of a government's operations and its financial position.

ADDENDUM TO THE 2010 ONTARIO BUDGET

In the *Addendum to the 2010 Ontario Budget: Ontario's Plan to Enhance Accountability, Transparency and Financial Management*, the government voiced its concerns over several changes recently proposed to public-sector accounting standards. Specifically, the government is of the opinion that some of the proposed changes are inconsistent with the aim of ensuring that "public-sector accounting standards continue to support sound public policy decision-making, government fiscal accountability, and the clear, transparent reporting of information on government finances to the public." In the addendum, the government points out that governments and public-sector organizations are different from private-sector organizations and that these differences need to be recognized in accounting standards. Specifically, users of private-sector financial reports want information to support their investment decisions, whereas users of public-sector financial reports want to know how their tax dollars were spent and whether the books are balanced. In its addendum, the government cited the following issues to illustrate its concerns:

- At present there are four different sets of accounting standards for use in the public sector in Canada: public-sector, government not-for-profit, rate-regulated, and profit-oriented. Each set of standards records and reports public-sector financial results differently. The government believes that this distorts transparency and fiscal accountability for the expenditure of public monies and that there is a need for PSAB to establish a consistent set

of accounting standards for all public-sector organizations in Canada as soon as possible.
- According to the government, PSAB's proposal to record market-value "paper" gains and losses related to financial instruments in public-sector results would not reflect the economic substance and exposure related to government transactions, and would reduce public understanding of government finances. The government is of the opinion that only actual realized gains and losses should be reflected in financial results.
- In light of increased uncertainty regarding the future of rate-regulated accounting under the International Financial Reporting Standards for government organizations and business enterprises, along with the need to ensure consistency with the decisions of regulatory authorities in Ontario, the government indicated that it may need to take action to ensure that the financial reports of rate-regulated entities continue to meet user needs.

In December 2009, ministers of finance from the federal, provincial, and territorial governments issued a joint letter to the chairs of the CICA Board of Directors, the Accounting Standards Oversight Council, and PSAB expressing their concern that PSAB had not yet addressed the critical differences between the accounting-standards requirements of the public and private sectors and the related impact on the public's understanding of government finances. The Ontario government indicated in the addendum that, in the interim, it will provide direction to provincial government organizations and enterprises to ensure that consistent, transparent, and accountable reporting is sustained in the Ontario public sector.

ADHERENCE TO ACCOUNTING STANDARDS

It is important to note that, in all material respects, the government's consolidated financial statements do comply with PSAB standards, and the government continues to improve in certain areas. For instance, in the 2009/10 fiscal year, the government further enhanced compliance with PSAB standards by recognizing depreciable assets such as vehicles, aircraft, and information technology infrastructure as capital expenditures, and amortizing their costs over the assets' useful lives. Previously, these capital expenditures were charged to current-year expenses as incurred.

However, one issue we do remain concerned about is the passage of the *Investing in Ontario Act, 2008*, in which the government, for the first time that we are aware of, has taken it upon itself to decree how transfers under this act will be accounted for rather than allowing generally accepted accounting standards to determine how such transfers would be accounted for. We initially raised this concern in our *2008 Annual Report*. The recent amendments put forth by the government to the *Education Act* and proposed amendments to the *Financial Administration Act* that specify the accounting standards to be used by government organizations and business enterprises once again indicate that the province may be starting down the path of legislating accounting standards rather than following generally accepted standards. As well, in the province's 2009/10 consolidated financial statements, there were two instances where the province's accounting and reporting practices were not fully consistent with PSAB standards.

The two instances of non-compliance with PSAB standards are discussed more fully as follows.

Consolidation of the Broader Public Sector

PSAB standards require that broader-public-sector (BPS) organizations deemed to be controlled by the government should be included in the province's consolidated financial statements beginning in 2004/05. The government determined that hospitals, school boards, and colleges met this criteria—and we agreed—and these sectors have been included in the province's consolidated financial statements since that time. PSAB permitted

governments to consolidate BPS organizations on the modified equity basis of accounting up to and including the 2008/09 fiscal year. Under the modified equity basis, the net assets of the BPS organizations have been reported as a single line item on the province's consolidated Statement of Financial Position, and each BPS organization's expenses net of fees, donations, and education property-tax revenues have been included in the related sector's expenses in the province's consolidated Statement of Operations.

For fiscal years that commence on or after April 1, 2009, PSAB standards require that BPS organizations be fully consolidated. This means that the assets, liabilities, revenues, and expenses of each BPS organization are to be combined on a line-by-line basis with the corresponding account in the province's consolidated financial statements. For instance, any non-government revenues received by hospitals, school boards, or colleges would be added to provincial revenues to arrive at a total revenue figure for the consolidated financial statements.

In its 2009/10 consolidated financial statements, the government fully consolidated the assets and liabilities of the BPS organizations. However, the government continued to net the revenues the BPS organizations receive from the public, such as tuition fees and donations, against the BPS organizations' expenses. According to the government, these revenues were not included with the revenues of the province because they were not available to the province to fund program costs. Only the education property-tax revenue reported by school boards is accounted for as government revenues in the province's consolidated financial statements. Under this "hybrid" consolidation approach, the province fully consolidates the balance sheet of the BPS organizations but continues to use the modified equity basis of accounting in consolidating their income statements. The government believes that its approach to consolidating the BPS organizations reflects the BPS organizations' bottom-line accountability relationship to the government to manage their operations within budget.

This approach to consolidating BPS organizations that Ontario has decided to adopt is unique among the provinces. We reviewed the consolidated financial statements of five of the larger provinces that have BPS organizations and noted that all five were fully consolidating their BPS organizations in accordance with PSAB standards.

However, from a "bottom-line" perspective, it is important to note that this departure from PSAB standards did not have an impact on either the province's net debt or its deficit—which we consider to be the key measures that the Legislature and the public use to assess how well the government has managed the public purse. Accordingly, we had advised the government early in the fiscal year that, although we recommended full compliance with PSAB standards, the proposed consolidation methodology would in itself not have a material impact on the fairness of the financial statements.

Accounting for Government Business Enterprises Not in Accordance with PSAB Standards

Two of the Ontario government's larger government business enterprises, Ontario Power Generation Inc. (OPG) and Hydro One Inc. (Hydro One), record their financial instruments at fair values in order to comply with the CICA's generally accepted accounting principles for private-sector organizations.

PSAB standards require that the financial activities and balances reported by a government business enterprise be reflected in the province's consolidated financial statements on the same basis they are recorded in the government business enterprise's financial statements. Therefore, in accordance with PSAB standards, the fair value adjustments recorded by OPG and Hydro One should be reflected in the province's consolidated financial statements.

However, the government does not follow this PSAB standard for certain types of financial instruments held by OPG and Hydro One. Specifically, the province removes the fair value adjustments related to a number of financial instruments recorded by OPG and Hydro One before combining their results with those of the province; therefore, the fair value adjustments are not reflected in the province's consolidated financial statements. This departure from PSAB standards resulted in the province's financial assets being overstated by $82 million, its accumulated deficit being understated by $46 million, and its deficit being understated by $36 million in its 2009/10 consolidated financial statements. The consequences of this departure would be more serious if the amounts were more significant.

Again, because the impact of this departure is not material, it did not affect our audit opinion on the province's 2009/10 consolidated financial statements. However, in our view, there is no accounting basis in PSAB to support the government's practice in this area. Our review of other jurisdictions, including the federal government, found that they comply with this PSAB accounting standard.

THE INDEPENDENCE AND OBJECTIVITY OF THE STANDARD-SETTING PROCESS

Ontario has made significant progress in enhancing the accountability, credibility, and usefulness of its consolidated financial statements over the past 15 years.

Although governments—regardless of which political party was in power over the last 15 years in Ontario—deserve credit for this, so do the CICA and PSAB for establishing generally accepted accounting principles for governments to follow. The province as a sovereign entity can create its own accounting standards. However, we are concerned that any attempt to establish accounting principles through legislation may be taking a step backward from the substantial progress made to date. We hold the view that, in the public sector, a fundamental principle of government accountability to its citizens is that it produce financial information in such a way that the Legislature and the public can rely on the credibility. We further believe that, for government financial statements to be credible, users should have confidence that the statements adhere to generally accepted and identifiable standards that are established by an independent, arm's-length standard-setting body. We firmly believe that the CICA is well established as the Canadian accounting profession's independent standard-setting body, and that the accounting standards it develops through its Public Sector Accounting Board provide governments, auditors, and users of government financial statements with an objective and appropriate basis for accounting and reporting on transactions.

Status of Certain Issues Raised in Prior Years

PENSION BENEFITS GUARANTEE FUND

The Pension Benefits Guarantee Fund (PBGF), established in 1980 under the *Pension Benefits Act* (Act in this section) is administered by the Superintendent of Financial Services for the Financial Services Commission of Ontario. The purpose of the fund is to guarantee the payment of certain pension benefits when eligible defined benefit plans are "wound up" (terminated) under conditions specified in the Act. It continues to be the only fund of this nature in Canada.

Under the Act, the PBGF is funded through premiums charged to and paid by private-sector pension plan sponsors. Participation in the PBGF is mandatory for many defined benefit pension plans registered in Ontario; it covers over 1.1 million pension plan members who belong to over 1,500 pension plans. The intention is for the PBGF to be self-financing, with funding received in the form of annual premiums based on per-member and

risk-related fees. The PBGF provides a maximum benefit of up to $1,000 per month to pensioners should their defined benefit plan have insufficient funds to pay the required pensions. Currently, PBGF fees are as low as $1 per pension plan member per year, with no minimum assessment per pension plan. However, there is a $100 maximum fee per pension plan member and a $4 million maximum assessment for pension plans with deficits.

The PBGF has historically been classified as a trust for provincial financial-statement accounting purposes because its assets and liabilities are not considered the financial responsibility of the province. As a result, the assets, liabilities, and operating results of the fund are excluded from the government reporting entity but do require disclosure in the notes to the province's consolidated financial statements.

2009/10 Update on Financial Condition

Recent corporate insolvencies and bankruptcies caused by corporate failures, the economic downturn, and other events have caused significantly larger claims to be made to the PBGF over the last few years.

We noted in last year's Annual Report that, as a result of claims made over the previous few years, the PBGF had an unfunded liability of $47 million as of March 31, 2009. In other words, bona fide claims exceeded the assets it held to pay for them by $47 million. This unfunded liability existed despite the fact that the province had provided financial assistance to the PBGF in the 2003/04 fiscal year in the form of a $330 million non-interest-bearing loan that was to be repaid in $11 million annual instalments over a 30-year period.

At that time, we also expressed concern about the financial health of the PBGF because additional companies' pension plans were in the position potentially to make claims, which, according to the notes to the PBGF's March 31, 2009, consolidated financial statements, "could significantly exceed [its] existing assets." We expressed our concern last year that the need for continued direct provincial assistance to the PBGF might indicate that it may no longer meet the public-sector accounting standards for classification as a trust in the Public Accounts. We recommended that the government formally assess the legitimacy of continuing to exclude the fund from the province's consolidated financial statements for the 2009/10 fiscal year.

On March 25, 2010, the Legislature approved an appropriation to enable the Minister of Finance to provide a $500 million grant to the PBGF in order to help stabilize the fund and cover the costs of recent plan windups. As a result of the grant provided to the PBGF, it reported a fund surplus of $103 million as of March 31, 2010.

External Actuary Review of the Pension Benefits Guarantee Fund

In November 2006, the government established an Expert Commission on Pensions to consult on possible changes to the *Pension Benefits Act* (Act in this section). Included in the commission's area of review was the PBGF.

In November 2008, the Expert Commission recommended that an examination be conducted to determine the appropriate fees and guarantees needed to ensure that the PBGF is governed on self-financing principles. The commission also recommended that the PBGF be administered at arm's length from the pension regulator.

In response, the government amended the Act to clarify that the PBGF is a self-sustaining fund, independent of the government. The amendments allow, but do not require, the government to provide grants or loans to the PBGF. The amended Act also emphasized that the PBGF's liabilities are limited to its assets. In addition, the government appointed an independent actuary to review the stability and financial status of the PBGF. The results of the study were published in the actuary's report, dated June 2010.

The independent actuary noted that, to be treated as a private insurer, in the absence of any

increase in assessments, the PBGF would require an upfront reserve net of current claims as of January 1, 2010, of between $680 million and $1.023 billion to cover expected future claims. According to the report, a one-time grant to cover anticipated 2010 claims would cover most expected future claims, but, given current assessments, it would not cover a future catastrophic claim.

Assuming that the PBGF received the one-time grant from the province to cover 2010 claims, the actuary determined that, in order to be considered self-sufficient over the long term and cover existing loan repayments and expected future claims plus expenses, the PBGF would require a 450% increase in the employer and employee assessment rates to fund benefits at the current maximum coverage level of $1,000 per month per employee.

As noted previously, the government provided the PBGF with a $500 million grant in March 2010. In addition, on August 24, 2010, the government announced other reforms that it planned to bring to the Legislature in fall 2010. These reforms included increasing PBGF revenue by establishing a minimum assessment of $250 per covered plan; raising the base fee per plan member from $1 to $5; raising the maximum fee per plan member in underfunded plans from $100 to $300; and eliminating the $4 million maximum assessment limit for underfunded plans.

Status of PBGF "Trust" Classification

It is my Office's view that, even with the proposed legislative reforms, we question whether the PBGF will meet the criteria to retain its "trust" classification for the 2010/11 fiscal year. The government's $500 million grant demonstrates the PBGF's dependence on the government to meet its financial obligations, and therefore jeopardizes its accounting treatment as a trust in the province's consolidated financial statements. In addition, based on the actuary's report, it appears that this dependency will continue in the future. Even with the $500 million grant and even if the proposed premium increases are implemented, the fund will probably remain significantly short of the $680 million to $1.023 billion required to meet expected future claims as estimated by the actuary. We believe that the PGBF may need to be included in the province's consolidated financial statements for the 2010/11 fiscal year, unless a substantial improvement in the unfunded liability or significant increases to employer premiums beyond those currently envisioned occur.

ACCOUNTING FOR CAPITAL TRANSFERS

We noted in last year's Annual Report that the government was not accounting for capital transfers received from other levels of government in accordance with PSAB standards. Under these standards, capital transfers are to be recognized as revenues when the province incurs the expenditures that make it eligible to receive the grants. We noted that the province had received significant federal grants over several years that, in our view, should have been recognized as revenues because the government had incurred expenditures in making itself eligible to receive the grants in question. However, the recognition of these grants as revenues had instead been deferred over the useful lives of the related assets that were acquired or constructed. We noted that as of March 31, 2009, these deferred amounts continued to grow but were not yet significant enough to have an impact on the fairness of the consolidated financial statements.

In May 2010, PSAB issued a Re-Exposure Draft on Government Transfers that addresses several issues related to how transfers are accounted for by both the transferor and the recipient. In essence, the re-exposure draft now allows a recipient government to recognize capital transfers over the related asset's useful life.

In assessing the proposed standard against the purpose and nature of the capital transfers received by the province and its fully consolidated organizations, we concluded that, because the ultimate purpose of the transfers is to construct or acquire assets

that provide services to the public over their useful lives, it is therefore appropriate to recognize these capital transfers in revenue over the useful life of the related acquired or constructed asset.

RATE-REGULATED ASSETS AND LIABILITIES

Rate regulation is an arrangement whereby a government-established authority approves the prices that a regulated entity can charge customers for its products or services. Regulators often prohibit regulated entities from immediately recovering all of their current costs in their current rates, ordering instead that such costs be "deferred" (and recorded as an asset) for recovery in future periods. Rate-regulated accounting practices were developed to recognize the unique nature of regulated entities such as electricity generators and of these types of transactions.

Three major provincially owned organizations in Ontario's electricity sector—Ontario Power Generation Inc., Hydro One Inc., and the Ontario Power Authority—use rate-regulated accounting, in accordance with the Canadian generally accepted accounting principles. The financial position and operating results of these three organizations are included in, and have a significant effect on, the government's consolidated financial statements. The net effect of rate-regulated accounting in the 2009/10 fiscal year was to increase the operating profits of government business enterprises by more than $900 million, thus reducing the government's overall reported deficit by the same $900 million.

Over the last two years, we have raised concerns about the appropriateness of recognizing rate-regulated assets and liabilities in the government's consolidated financial statements. From a theoretical viewpoint, we questioned whether rate-regulated assets and liabilities meet the definition of bona fide assets or liabilities for the purposes of government consolidated financial statements. However, we acknowledged that PSAB specifically allows government business enterprises to be consolidated without any adjustment of their accounting policies, and therefore we accepted this accounting treatment.

We continue to be concerned, however, about their inclusion; because both the regulator and the regulated entity are owned and controlled by the government that created them, the government has significant influence on what costs will be recognized in the electricity sector in any given year rather than these decisions being made by a totally independent regulator. An argument could therefore be made that all assets and liabilities and any income impact arising from rate-regulated accounting should be removed from the government's consolidated financial statements as part of the consolidation process. PSAB already calls for all assets and liabilities that arise from inter-organizational transactions to be removed using such adjustments, and the government does so for all of its internal transactions except those in the electricity sector. In our view, it could simply extend this practice to all government operations to ensure that the province's financial results appropriately reflect and fairly present the government's transactions with external parties.

We commented in our *2009 Annual Report* that the CICA was adopting international accounting standards as part of its move to harmonize Canada's accounting practices with those in numerous other countries. We also noted that the International Financial Reporting Standards (IFRS) were silent on rate-regulated activities. This left those rate-regulated entities in Canada preparing to adopt the IFRS unclear as to whether they would still be allowed to recognize these rate-regulated assets and liabilities.

Since that time, there have been a number of developments. The latest of these came in September 2010, when the CICA's Accounting Standards Board (AcSB) noted that the London-based International Accounting Standards Board (IASB) will consider whether to amend the IFRS to make clear that they do not permit recognition of regulatory assets and regulatory liabilities. The IASB was also

considering whether to incorporate issues relating to rate regulation into a future project on intangible assets. The AcSB decided that in view of this and other recent standard-setting activities in this area, entities with rate regulated activities may need additional time to prepare for the IFRS. The AcSB also decided that an optional deferral of the mandatory changeover date to the IFRS for this sector was warranted, but that the deferral should be for only one year, regardless of the disposition of the IASB's Rate-Regulated Activities Project. This means that entities such as Ontario's electricity-sector organizations with rate-regulated activities must now adopt the IFRS in their financial statements for fiscal periods beginning on or after January 1, 2012.

Although we support the AcSB's position on this issue, the government has expressed concern about it. In the 2010 Budget Addendum, the government indicated the following:

> In light of increased uncertainty regarding the future of rate-regulated accounting under IFRS and the need to ensure consistency with the decisions of regulatory authorities in Ontario, the government may need to take action to ensure the financial reports of rate-regulated entities continue to meet user needs.

We certainly agree with the government's desire to ensure that the financial reports of rate-regulated entities meet user needs. However, we are not convinced that ensuring "consistency with the decisions of regulatory authorities" necessarily achieves this aim. Along with the AcSB, we believe that users of a government's consolidated financial statements benefit most from statements that reflect actual results rather than results that, at a government's discretion, can exclude actual expenses if a government decides not to recover such costs from current electricity ratepayers. In essence, the costs are simply deferred for future generations to pick up.

Public Sector Accounting Board Initiatives

This section briefly outlines some of the more significant issues that the Canadian Institute of Chartered Accountants' (CICA's) Public Sector Accounting Board (PSAB) has been dealing with over the last year that may in future affect the province's consolidated financial statements.

INTRODUCTION

The CICA's Accounting Standards Board (AcSB), which is responsible for establishing Canadian accounting and financial reporting standards, is implementing a number of financial reporting changes to be used by all publicly traded companies. By 2011, the current Canadian generally accepted accounting principles used to prepare the financial statements of publicly accountable, profit-oriented enterprises will be replaced by an accounting framework set out in the International Financial Reporting Standards (IFRS). The AcSB is also reviewing and updating the standards applicable to not-for-profit organizations. These changes reflect the ongoing globalization of financial markets and the movement toward worldwide standards in several areas of business and government.

As indicated earlier in this chapter, PSAB has the authority to set accounting standards for the public sector. Some of the more significant financial accounting and reporting issues PSAB is currently working on include accounting for financial instruments, government transfers, and foreign exchange, and the impact of the IFRS on government business enterprises and public-sector not-for-profit organizations.

STANDARDS

Financial Instruments

The province uses financial instruments and derivatives, such as foreign-exchange forward contracts, swaps, futures, or options, to manage or hedge against risks related to debt it has issued in foreign currencies and/or at variable interest rates. Currently, PSAB guidance on accounting for derivatives is limited to their application in hedging foreign-currency items, such as the foreign-currency risk associated with holding a debt repayable in U.S. dollars.

In January 2005, the AcSB approved three new handbook sections, titled "Financial Instruments," "Comprehensive Income," and "Hedges," relating to such activities. Although these handbook sections were developed for the private sector—governments were not required to apply them—they did underscore the need to eventually address these issues from a public-sector perspective. Accordingly, PSAB has created a task force to consider how governments should account for financial instruments. One of the key issues the task force will address is whether changes in the fair market value of derivative contracts, similar to fluctuations in the market value of equities and bonds, should be recognized in a government's financial statements. A key aspect of this issue is whether such changes should affect the determination of a government's annual surplus or deficit.

The main rationale for recognizing changes in the fair market value of financial instruments is to ensure that, at the end of each fiscal period, assets and liabilities of an organization are recognized at their current value rather than their historical acquisition value. However, if such changes in value were recognized as immediate gains or losses, they could have a significant impact on the organization's annual surplus or deficit, even though such gains or losses may not have been realized and could be reversed in future years.

PSAB issued its Exposure Draft on Financial Instruments in September 2009. Among its more significant recommendations is that all gains and losses from fair value re-measurement be recorded in the Statement of Operations and that these gains and losses be reported separately from the province's other revenues and expenses so that the province's surplus or deficit clearly distinguishes the impact of re-measurement gains and losses. Hedge accounting would no longer be required, which would reduce some of the complexities associated with accounting for financial instruments that is present in the CICA standards. PSAB notes that the recommendations in this exposure draft will bring the financial accounting and reporting of financial instruments, including derivatives, in line with international developments. These proposed standards are essentially consistent with the accounting used by the private sector.

Responses from all governments to the exposure draft raised concern about the volatility that the proposed changes would likely introduce in government financial statements, especially in the calculation of the government's annual surplus or deficit. As well, a number of these responses observed that users would be confused with the two "bottom lines" that would arise from presenting gains and losses from fair value re-measurements separately from the government's other revenues and expenses. We share this particular concern. Specifically, users may not be able to readily distinguish which measure of the surplus or deficit is the true measure of the government's fiscal performance for the year.

PSAB is currently developing a re-exposure draft, to be issued in the near future, that addresses the concerns raised in the September 2009 exposure draft. Specifically, PSAB has indicated that it is considering excluding fair value re-measurement gains and losses from the Statement of Operations and presenting these in a separate financial statement—the Statement of Re-measurement Gains and Losses. Combined, the Statement of Operations and the Statement of Re-measurement Gains and Losses would then capture all changes in assets and liabilities, including changes in fair value.

Foreign-currency Translation

At present, PSAB standards include recommendations that allow gains and losses on foreign-currency-denominated items to be deferred and amortized to operations over time. PSAB notes that its accounting standard is the only one among the major accounting standards used throughout the world that allows deferral and amortization of such foreign-exchange gains and losses, and that this approach is not consistent either with its conceptual framework or with generally accepted asset and liability definitions.

In October 2009, PSAB issued an Exposure Draft on Foreign Currency Translation. Consistent with the direction provided in the September 2009 Exposure Draft on Financial Instruments, this exposure draft proposes to replace the current deferral provisions with the requirement that foreign-exchange gains and losses be immediately recognized as re-measurement gains and losses in the determination of the annual surplus or deficit. Again, these would be reported separately from the province's other revenues and expenses so that the province's surplus or deficit clearly distinguishes the impact of re-measurement gains and losses arising from foreign exchange.

However, comments received on the October 2009 exposure draft raised largely the same concerns as those about the September 2009 Exposure Draft on Financial Instruments. Accordingly, PSAB is currently developing a re-exposure draft to be issued in the near future. The proposed standards in the re-exposure draft, similar to the re-exposure draft on financial instruments, would report re-measurement gains and losses outside of the statement of operations.

Government Transfers

PSAB has been working for some time to amend its standard on government transfers to address a number of issues raised by the government community. Although there are a number of issues that need to be addressed, the principal question concerns how multi-year funding for capital transfers provided by one government to another should be accounted for. Given the billions of dollars in government transfers made annually, the revised standard has the potential to significantly affect a government's reported financial results.

A variety of views have been expressed, and PSAB has faced challenges in obtaining a consensus on the revisions that should be made to the existing standard.

As indicated earlier, the more recent re-exposure draft, issued in May 2010, would essentially allow a recipient government to recognize a transfer as a liability rather than immediately as revenue if the transfer must be used to provide services in the future. PSAB is currently analyzing the comments received on this third re-exposure draft, and a final standard is expected by early 2011.

Financial Reporting by Government Not-for-profit Organizations

Currently, government not-for-profit organizations, such as hospitals, colleges, and universities, are directed by PSAB to follow the CICA standards for not-for-profit organizations. The AcSB establishes generally accepted accounting principles for private-sector profit-oriented enterprises and private-sector not-for profit organizations. The AcSB is in the process of evaluating options for future financial reporting and accounting standards for private-sector not-for-profit organizations. In March 2010, PSAB issued an Exposure Draft on Financial Reporting by Government Not-for-Profit Organizations. PSAB is currently analyzing the comments received on this exposure draft.

PSAB's Conceptual Framework

PSAB's conceptual framework is a set of interrelated objectives and fundamentals that support the development of consistent accounting standards. It is the basis on which interested stakeholders,

including legislative auditors, those who prepare government financial statements, and the PSAB discuss and assess proposals to address accounting issues. The key benefit of the conceptual framework is that it instills discipline into standard-setting and ensures that accounting standards are objective, credible, and consistent.

In response to concerns raised by the senior government finance community, PSAB is implementing a strategy to review its conceptual framework. PSAB has formed the Conceptual Framework Task Force, the objective of which is to review the appropriateness of the concepts and principles in the existing conceptual framework for the public sector in the Public Sector Accounting Handbook. The Task Force was to begin meeting in fall 2010.

Statutory Matters

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 Assembly.

LEGISLATIVE APPROVAL OF EXPENDITURES

Shortly after presenting its budget, the government tables detailed Expenditure Estimates in the Legislative Assembly outlining, on a program-by-program basis, each ministry's spending proposals. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and presents a report on them to the Legislature. The estimates of those ministries that are not selected for review are deemed to be passed by the Committee and are so reported 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 two 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, 2010, received Royal Assent on May 18, 2010.

The *Supply Act* is typically not passed until well after the start of the fiscal year—and sometimes even after the related fiscal year—but ministry programs require interim funding approval prior to its passage. For the fiscal year ending March 31, 2010, the Legislature authorized these payments by passing two acts allowing interim appropriations: the *Interim Appropriation for 2009–2010 Act, 2008;* and the *Supplementary Interim Appropriation for 2009–2010 Act, 2009*. These two acts received Royal Assent on November 28, 2008, and June 5, 2009, respectively, and authorized the government to incur up to $101.1 billion in public service expenditures, $3.1 billion in investments of the public service, and $173.3 million in legislative office expenditures. Both acts were made effective as of April 1, 2009, and provided the government with sufficient temporary appropriations to allow the government to incur expenditures from April 1, 2009, to March 31, 2010.

Because the legal spending authority under these two acts was intended to be temporary, they were repealed under the *Supply Act, 2010,* and the authority to incur expenditures provided under them was subsumed into the authority provided under the *Supply Act, 2010*.

SPECIAL WARRANTS

Section 1.0.7 of the *Financial Administration Act* allows for the issuance of Special Warrants authorizing the incurring of expenditures for which there is no appropriation by the Legislature or for which the appropriation is insufficient. Special Warrants

are authorized by Orders-in-Council approved by the Lieutenant Governor on the recommendation of the government.

For the fiscal year ending March 31, 2010, one Special Warrant totalling $21,311,300 was approved by an Order-in-Council dated March 4, 2010. This Special Warrant was required because the amount of expenditures authorized under the *Interim Appropriation for 2009–2010 Act, 2008* and the *Supplementary Interim Appropriation for 2009–2010 Act, 2009* was not sufficient after March 3, 2010. As a result, the Special Warrant allowed legislative offices to incur expenditures from March 4, 2010, until the end of the fiscal year.

TREASURY BOARD ORDERS

After December 15, 2009, section 1.0.8 of the *Financial Administration Act* allows the Treasury Board to make an order authorizing expenditures to supplement the amount of any voted appropriation that is expected to be insufficient to carry out the purpose for which it was made. (The *Treasury Board Act, 1991* allowed these orders before it was repealed on December 15, 2009.) The order may be made only if the amount of the increase is offset by a corresponding reduction of expenditures to be incurred from other voted appropriations not fully spent in the fiscal year. The order may be made at any time before the books of the government for the fiscal year are closed. The government considers the books to be closed when any final adjustments arising from our audit have been made and the Public Accounts have been tabled in the Legislature.

Even though the *Treasury Board Act, 1991* has been repealed, subsection 5(4) of the repealed act continues to allow 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 that the board may specify. This delegation under the repealed act will continue to be in effect until replaced by a new delegation. For the fiscal year ended March 31, 2010, the Treasury Board delegated its authority to ministers for issuing Treasury Board Orders to make transfers between programs within their ministries, and to the Chair of the Treasury Board for making transfers in programs between ministries and making supplementary appropriations from contingency funds. Supplementary appropriations are Treasury Board Orders whereby the amount of an appropriation is offset by reducing the amount available under the government's centrally controlled contingency fund.

Figure 7 summarizes the total value of Treasury Board Orders issued for the past five fiscal years. Figure 8 summarizes Treasury Board Orders for the fiscal year ended March 31, 2010, by month of issue. Treasury Board Orders increased significantly over the 2008/09 fiscal year, primarily in the Ministry of Finance and Ministry of Energy and Infrastructure, as a result of loans to the auto sector and infrastructure stimulus spending.

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 2009/10 fiscal year are expected to be published in *The Ontario Gazette* in December 2010. A detailed listing of 2009/10 Treasury Board Orders, showing the amounts authorized and expended, is included as Exhibit 3 of this report.

Figure 7: Total Value of Treasury Board Orders Issued, 2005/06–2009/10 ($ million)

Source of data: Treasury Board

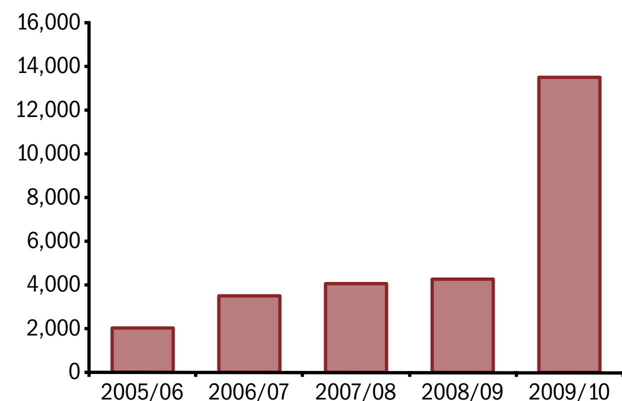


Figure 8: Treasury Board Orders by Month of Issue, 2009/10

Source of data: Treasury Board

Month of Issue	#	Authorized ($)
April 2009–February 2010	89	3,534,624,200
March 2010	36	8,983,994,500
April 2010	11	980,752,400
May 2010	1	295,000
July 2010	1	1,790,000
Total	**138**	**13,501,456,100**

TRANSFERS AUTHORIZED BY THE BOARD OF INTERNAL ECONOMY

When the Board of Internal Economy authorizes the transfer of money from one item of the Estimates of the Office of the Assembly to another item within the same vote, section 91 of the *Legislative Assembly Act* requires that we make special mention of the transfer(s) in our Annual Report.

Accordingly, with respect to the 2009/10 Estimates, the following transfers were made within Vote 201:

From:	Item 1	Office of the Speaker	$ (55,700)
	Item 3	Legislative Services	$ (54,500)
	Item 4	Information and Technology Services	$ (21,100)
	Item 6	Sergeant at Arms and Precinct Properties	$ (42,200)
To:	Item 2	Office of the Clerk	$ 5,800
	Item 5	Administrative Services	$ 165,500
	Item 12	Lieutenant Governor's Suite	$ 2,200

UNCOLLECTIBLE ACCOUNTS

Under section 5 of the *Financial Administration Act*, the Lieutenant Governor in Council, on the recommendation of the Minister of Finance, may authorize an Order-in-Council to delete from the accounts any amounts due to the Crown that are deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2009/10 fiscal year, receivables of $410.3 million due to the Crown from individuals and non-government organizations were written off (in 2008/09, the comparable amount was $390.2 million). The major portion of the writeoffs related to the following:

- $316.7 million for uncollectible receivables under the Student Support Program (2008/09 – $14.9 million);
- $55.5 million for uncollectible corporate tax (2008/09 – $138 million);
- $21.4 million for uncollectible retail sales tax (2008/09 – $126.5 million);
- $5.4 million for uncollectible employer health tax (2008/09 – $25.9 million); and
- $5 million for uncollectible receivables under the Ontario Disability Support Program (2008/09 – $12 million).

Volume 2 of the 2009/10 Public Accounts summarizes the writeoffs by ministry. Under the accounting policies followed in the preparation of the consolidated financial statements of the province, a provision for doubtful accounts is recorded against accounts receivable balances. Accordingly, most of the writeoffs had already been expensed in the government's consolidated financial statements. However, the actual deletion from the accounts required Order-in-Council approval.