
CHAPTER FIVE

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 financial statements, and three supplementary volumes.

The 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 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. The financial statements, along with the 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 financial statements, summaries and analyses of the province's financial condition and fiscal results. 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 include the following:

- Volume 1 contains the Consolidated Revenue Fund schedules and ministry statements. Commencing this fiscal year, these schedules and statements reflect the financial activities of the government and its ministries on the accrual basis of accounting.
- Volumes 2A and 2B contain the audited financial statements of the significant provincial Crown corporations, boards, and commissions that are part of the government's "reporting entity" (that is, all organizations whose activities are

included in the government's financial statements), as well as other miscellaneous financial statements.

- Volume 3 contains detailed schedules of ministry payments, as well as the salary disclosure required under the *Public Sector Salary Disclosure Act, 1996*.

Our Office reviews the information in the annual report and Volume 1 of the Public Accounts for consistency with the information presented in the financial statements.

Commencing in the 2003/04 fiscal year, 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. The annual report and three supplementary volumes of the Public Accounts for the 2003/04 fiscal year were all made public on September 27, 2004.

THE PROVINCE'S 2003/04 FINANCIAL STATEMENTS

The *Audit Act* requires that the Provincial Auditor report annually on the results of the Auditor's examination of the province's financial statements. This year, as a result of the Provincial Auditor's retirement in September 2003, it was again my responsibility, in my capacity as the Assistant Provincial Auditor, to express an audit opinion on the financial statements. I am pleased to report that my Auditor's Report to the Legislative Assembly on the financial statements for the year ended March 31, 2004 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, 2004 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 financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 2004 and the results of its operations, the changes in its net debt, and its cash flows for the year then ended in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants.

[signed]

Toronto, Ontario
August 20, 2004

Jim McCarter, CA
Assistant Provincial Auditor

EXPANDING THE GOVERNMENT REPORTING ENTITY

The “government reporting entity” refers to, collectively, all of the organizations whose activities are included in the government’s financial statements. One of the most critical aspects of reporting on a government’s financial affairs is deciding which organizations—from among, for example, ministries, agencies, Crown-controlled corporations, boards, commissions, and organizations receiving transfer payments—should be included in the reporting entity. Inclusion in the reporting entity essentially means that an organization’s operating results and its assets and liabilities are consolidated with or otherwise incorporated into the government’s financial statements, so that they form part of both the government’s *annual* deficit or surplus and its *accumulated* deficit or surplus.

The government’s financial statements reflect the accounting standards recommended by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). The PSAB standard relating to the reporting entity for the fiscal year ended March 31, 2004 recommends that an organization be included in the government’s financial statements if:

- 1) it is accountable for the administration of its financial affairs and resources either to a minister of the government or directly to the Legislature, and
- 2) it is owned or controlled by the government.

In accordance with that standard, Ontario’s financial statements for the fiscal year ended March 31, 2004 include, in addition to the activities of all government ministries, those of 30 of its most significant organizations, such as Ontario Power Generation Inc., Hydro One Inc., the Ontario Electricity Financial Corporation, the Ontario Lottery and Gaming Corporation, the Liquor Control Board of Ontario, GO Transit, and the Ontario Housing Corporation. The activities of less significant government organizations are only included to the extent that any funding provided by the ministries responsible for them are already reflected in the statements.

In August 2003, PSAB revised its reporting-entity standard for fiscal years beginning on or after April 1, 2005. The new standard reduces the inclusion criteria to one overall consideration—that of government control. In essence, if a government controls an entity, it must be included in the government’s reporting entity. Assessing the degree of government control is not an exact science and requires the exercise of professional judgment. Accordingly, the standard offers extensive guidance in assessing the degree to which government control exists over any particular entity.

Many entities that did not meet the previous inclusion criteria need to be assessed against this new PSAB standard. For the most part, these are public sector or quasi-public-sector institutions that operate outside of the government ministry and agency structure but are primarily funded by the government. While there are hundreds of these organizations, the most significant ones are in the “SUCH” sector (“SUCH” stands for school boards, universities, colleges, and hospitals, including long-term-care facilities). Including these institutions in the government’s financial statements would have a significant impact on the province’s reported financial position and its annual operating results.

In our last two Annual Reports, we have urged the Ministry of Finance to complete such an assessment and reported on our own efforts to examine various sources of evidence—such as legislation, regulations, reporting arrangements, and ministry accountability documents pertaining to SUCH-sector institutions—to assess whether any SUCH-sector institutions should be considered for inclusion under the new standard. We reported our view that the two strongest candidates for future consolidation into the government reporting entity were Ontario’s colleges and school boards, followed to a lesser extent by Ontario’s hospitals and long-term-care facilities.

This year we are pleased to report that the government has completed its own reporting-entity assessment. The government announced in the 2004 Ontario Budget its intention to add the province’s 105 school boards and school authorities, 24 community colleges, and 154 hospitals to its reporting entity. In accordance with the new standard, these institutions would be consolidated into the province’s financial statements for the first time in the 2005/06 fiscal year.

This change will be significant. Effective for the 2005/06 fiscal year, the province’s annual surplus or deficit will include the impact of these organizations’ annual surpluses or deficits, and their net assets or net debts will be included in the calculation of the province’s net debt. Transfers to these organizations for capital purposes will no longer be treated as a current expense of the government; rather, the capital assets acquired or constructed with these transfers will form part of the province’s investment in capital assets.

As well as complying with the new PSAB standard, inclusion will make Ontario’s financial statements more comparable to those of many other provinces that are

currently including these organizations in their reporting entities, as can be seen in the chart below.

Status of School Boards, Colleges, and Hospitals in Reporting Entities

Jurisdiction	Fiscal Year of Latest Published Financial Statements	School Boards Included	Colleges Included	Hospitals Included
British Columbia	2003/04	✓ ¹	✓ ¹	✓ ¹
Alberta	2003/04	(✓) ²	(✓) ²	(✓) ²
Saskatchewan	2003/04		✓	✓
Manitoba	2002/03		✓	✓
Quebec	2002/03			
New Brunswick	2002/03	✓	✓	✓
Nova Scotia	2002/03	✓	✓	✓
Prince Edward Island	2002/03	✓		✓
Newfoundland and Labrador	2002/03	✓	✓	✓

¹ The government of British Columbia indicated in its 2003/04 summary financial statements that it would include these institutions in their reporting entity commencing in the 2004/05 fiscal year.

² The government of Alberta indicated in its 2003/04 summary financial statements that it would review these institutions and, if it determines that control exists, include them in its reporting entity commencing in the 2006/07 fiscal year.

In Ontario, there will be a number of issues to resolve over the next couple of years regarding the consolidation of these entities. These issues include dealing with fiscal year ends and accounting policies that differ between the entities and the province; obtaining reasonable assurance that the new consolidated amounts have been accounted for correctly and represent bona fide provincial assets, liabilities, revenues, and expenses; and ensuring that the presentation and disclosure of these consolidated entities within the government's financial statements is appropriate.

For the SUCH-sector organizations to be fully consolidated into the reporting entity, as required by the new PSAB standard, their accounting policies must be the same as those of the province and their revenues, expenses, assets, and liabilities must be combined on a line-by-line basis with those of the province. Recognizing the challenges posed by these requirements, PSAB approved transitional provisions in March 2004 that would temporarily allow governments to consolidate the new organizations on a "modified equity" rather than a "fully consolidated" basis. These provisions are in effect until fiscal years beginning on or after April 1, 2008. Under the provisions, as long as certain criteria are met, the new organizations' accounting policies are not required to be the same as those of the province and their total net assets and surpluses or deficits may be shown as a single line item on the province's statements.

In its 2004 Budget, the government expressed serious concerns about the eventual need to consolidate these new organizations on a line-by-line basis and expressed its preference that modified equity accounting be adopted on a permanent basis, given the nature of the relationship between the government and these organizations. We will work with the Ministry of Finance to resolve this issue prior to the expiry of the PSAB transitional provisions.

STRANDED DEBT OF THE ELECTRICITY SECTOR

In 1998, when the Ontario government restructured the electricity sector, one of the most critical steps in the restructuring process was determining the fair market value of the assets to be transferred from Ontario Hydro to the new hydro operating companies—Ontario Power Generation (OPG) and Hydro One—in a competitive, as opposed to a monopoly, environment. Both Ontario Hydro and the government, assisted by private-sector investment firms and other experts, recognized that the market value of these assets in a competitive environment would be significantly less than the amounts that were recorded in the accounts of Ontario Hydro. The shortfall between these revalued assets and the value of Ontario Hydro’s total debt and other liabilities being transferred to the new entities constituted “stranded debt.”

The stranded debt became the responsibility of the Ontario Electricity Financial Corporation (OEFC), a new agency of the province. The Ministry of Finance determined that the total debt and other liabilities of Ontario Hydro, which were assumed by the OEFC, amounted to \$38.1 billion. This amount exceeded the market value of Ontario Hydro’s assets of \$18.7 billion that the OEFC also received. The shortfall created a stranded debt of approximately \$19.4 billion, which represented the amount of debt and other liabilities of the OEFC that could not be serviced in a competitive environment. Consequently, when the OEFC commenced operations on April 1, 1999 it had a stranded debt, or an unfunded liability, of \$19.4 billion that the province, through the OEFC, became responsible for retiring.

Since that time, the stranded debt included in the province’s financial statements has increased to \$20.6 billion. While this stranded-debt liability is now included with the province’s other liabilities, the government intends for the stranded debt to be recovered from electricity ratepayers rather than from taxpayers. However, for several years now we have expressed the concern that there is an increasing risk that part or all of the stranded debt will not be recovered from electricity ratepayers. Recent developments continue to support this view. For instance, during the 2003/04 fiscal year, the stranded debt liability increased by another \$367 million. In fact, the stranded debt has increased almost every year since April 1, 1999 when the electricity sector was restructured, as shown in the following table.

**Electricity Sector Stranded Debt,
1999–2003/04**

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

*Prepared by Office of the
Provincial Auditor*

The primary reasons for the increase in the stranded debt in the 2003/04 fiscal year were the \$253 million cost of the Ontario government's 4.3 cent/kWh price freeze for low-volume and designated consumers and OPG's net loss of \$491 million for the year ended December 31, 2003, which prevented it from making the expected contribution to OEFC to reduce the stranded debt. This loss was due to OPG writing off \$576 million of the value of its coal-fired generating stations—a move that was made necessary by a government policy commitment to phase out coal-fired generating stations by the end of 2007.

When the stranded debt was assumed by the OEFC, the government established a long-term plan to retire the debt solely from dedicated revenue streams derived from the electricity sector. This long-term plan is updated annually to reflect current information and assumptions. As with any long-term plan, there is a high degree of uncertainty as to whether forecasted results will be achieved. In the past year, two significant developments have occurred that are indicative of these uncertainties.

First, on June 15, 2004, the government introduced legislation to again reform the electricity sector. If passed by the Legislature, these latest reforms would result in a combination of a fully regulated and a competitive electricity sector, with different generators receiving different prices set through a variety of mechanisms. The government estimates that this move to a regulated price structure will likely result in significantly lower long-term results from what had previously been projected for OPG operating wholly in a competitive marketplace. As OPG earnings are a key source for retiring the stranded debt, this means that it would take longer to pay off the stranded debt than initially projected.

Second, the current stranded-debt liability of \$20.6 billion includes \$4.0 billion relating to liabilities for power-purchase contracts entered into by the old Ontario Hydro. Under these contracts, power is to be purchased at prices that are expected to exceed current market prices. If the proposed reforms discussed above are passed by the Legislature and the reformed market becomes operational, the OEFC would

receive the actual contract prices for generated power from electricity consumers and the government would no longer subsidize these above-market prices. Under this scenario, the OEFC and the province believe that the liability from above-market contract prices could be eliminated when the reforms are implemented. The Ontario Budget for the 2004/05 fiscal year estimates that the fiscal impact of this would be a one-time revenue gain of almost \$4.0 billion in the year the proposed legislation is implemented, which the government expects to be the 2004/05 fiscal year. We will work with the OEFC and the province to assess whether this proposed accounting treatment is appropriate.

ACCOUNTING FOR CAPITAL ASSETS

In January 2003, PSAB revised a 1997 standard setting out rules for the recognition, measurement, amortization, and presentation of capital assets in a government's financial statements. Until recent years, most governments, including that of Ontario, had charged to operations 100% of the cost of capital assets in the year such assets were acquired or constructed. The revised standard recommends that, similar to the private sector, the cost of capital assets be recorded as assets in government financial statements and be amortized to expense over their estimated useful lives.

The government phased in its adoption of these PSAB recommendations beginning in the 2002/03 fiscal year by valuing and capitalizing the province's land holdings, buildings, and transportation infrastructure. As a result, in 2003 the government recognized for the first time over \$13 billion of net capital investments. These account for an estimated 90% or more of the government's total tangible capital assets.

Although no specific timetable has been set, the government has indicated that over the next several years it intends to adopt this PSAB standard for Ontario's remaining tangible capital assets, such as its computer systems, vehicles and equipment, and other smaller-value capital items. We encourage the government to complete its capitalization project as soon as possible and include these assets and related amortization in its financial statements.

PENSION BENEFITS GUARANTEE FUND

The purpose of the Pension Benefits Guarantee Fund (Fund) is to guarantee the payment of certain pension benefits when eligible defined benefit pension plans are "wound up" (that is, terminated) under conditions specified in the *Pension Benefits Act*. The Superintendent of Financial Services, pursuant to the *Pension Benefits Act*, is responsible for the administration of the Fund.

Pension payouts from the Fund are funded by assessments paid by pension-plan sponsors (primarily from the private sector). Since Fund liabilities are not considered to be a financial responsibility of the province, the Fund is classified as a trust for provincial financial-statement accounting purposes. As such, the Fund is excluded from the government reporting entity, although the assets and liabilities of the Fund are disclosed in the notes to the province's financial statements.

Events occurring over the last couple of years have the potential to require a change to the classification of the Fund as a trust. Because considerable claims have been made against the Fund over the last few years, the Province provided the Fund with a \$330 million interest-free loan in the 2003/04 fiscal year. This non-interest-bearing loan is repayable over 30 years in equal installments of \$11 million each year. The cost of this loan to the province was reflected in the 2003/04 financial statements as \$162 million, which reflects the interest foregone at market rates over the loan's full term. As a result of the claims and the loan, the Fund has an unfunded liability of over \$107 million as at March 31, 2004.

The future financial health of the Fund is also affected by the potential for significant future claims from three companies operating under a stay under Canadian federal legislation entitled the *Companies' Creditors Arrangement Act*, which allows financially troubled corporations the opportunity to restructure their affairs. While as of March 31, 2004, the outcomes of the restructuring efforts of these companies are not determinable, the possible subsequent claims against the Fund could be in the hundreds of millions of dollars.

Our Office will be closely monitoring future developments of the Fund to ensure it continues to meet the criteria for trust classification. If the burden to the plan sponsors of funding pensions relating to wound-up pension plans is too great and the province provides recurring direct financial assistance to the Fund, then the Fund would likely not be considered a trust for financial statement purposes. This is because, once the liabilities of a trust are no longer entirely funded by external parties, the activities of the trust would need to be considered for inclusion in the province's financial statements.

INTEGRATED FINANCIAL INFORMATION SYSTEM

In late 1998, the Management Board of Cabinet approved a Ministry of Finance proposal for a government-wide move to an integrated financial system. The resulting system, known as the Integrated Financial Information System (IFIS), is replacing the existing central accounting system of the government, which has operated under the modified cash basis, along with a number of different legacy accounting systems used by government ministries. IFIS is being implemented in phases, or waves.

Implementation began in two pilot ministries in November 2002. As of March 31, 18, or approximately 70%, of Ontario's ministries, responsible for just over 40% of the government's total expenditures, were using the IFIS system. In fall 2004, all remaining ministries migrated to the IFIS system. The Office of the Provincial Controller has overall responsibility for IFIS, and the Shared Services Bureau (SSB) is the primary business operator processing IFIS transactions.

Unlike the previous accounting systems used by the government, the IFIS system is a full accrual accounting system and supports the government's adoption over the last several years of accrual accounting for its budget, its estimates, and its appropriation control system. It is also now the main source of accounting information used in the production of the Public Accounts of the province, including its summary financial statements. Accordingly, as part of our audit of the province's financial statements, this year we conducted additional work on the new system. The purpose of our work was to update our understanding of this new system and to obtain assurance that key internal controls were operating satisfactorily and that government transactions were being properly processed. We did not include revenue transactions in the scope of this review, since to date very little revenue is being processed by the IFIS system. We also were able to place some reliance on work conducted by internal audit and an independent control review commissioned annually by the Ministry of Finance.

While we found the overall control environment to be satisfactory, we did note certain control weaknesses that we recommended be addressed in order to improve system controls and reduce the risk of fraud and error. Our concerns included the following:

- Encumbrances are a means of recording commitments for future expenses in IFIS and are a tool for ensuring appropriations are not exceeded. The Office of the Provincial Controller, which is responsible for establishing government accounting policies, has issued an encumbrance policy emphasizing the importance of encumbrance information in managing government budgets. The policy calls for all ministries and agencies to encumber all expected future significant transfer payments, service and consulting contracts, leases, and other commitments, with the exception of those relating to salaries, wages, benefits, travel, and certain credit-card transactions. In the case of transfers, encumbrances would be based on signed agreements with transfer-payment recipients; for operating expenditures, they would be based primarily on issued purchase orders. We noted that the majority of transfer payments were as yet not being encumbered, and, while operating expenditures were being encumbered to a greater degree, significant portions were not.
- There were certain inconsistencies between the various transaction-processing centres operated by SSB in the application of controls that ensured the accuracy and completeness of payments and journal processing and the security of advance cheques.

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- There was a risk of unauthorized payments because ministries were not always providing updated authority delegations to the transaction-processing centres.
 - There were some weaknesses in the application of controls that ensure that suppliers are accurately set up in the IFIS system.
 - There were weaknesses in authorization controls that created a risk that invalid requisitions for goods and services could be issued.

Although the weaknesses detected were not significant enough to impact our overall conclusion that the IFIS system was generally reliable, they do need to be rectified. We have received assurance from SSB management that action is currently underway or will be taken shortly to address the concerns under its control. For the remaining issues, we will be working with the Office of the Provincial Controller to ensure that these are also addressed.

NEW ACCOUNTING STANDARDS AND PROPOSALS

The Public Sector Accounting Board (PSAB) serves the public interest and that of the profession by recommending accounting standards that will improve the financial and performance information reported by governments and other public-sector entities. Such improved information benefits decision-makers and other users of the information.

The most significant issues PSAB has been dealing with over the last year that will or may affect the province's financial statements are briefly outlined below.

LIABILITY RECOGNITION

In June 2004, PSAB approved three new standards on, respectively, liabilities, contingent liabilities, and contractual obligations. Under the standards, governments would recognize a liability when there is a preponderance of evidence that the government has lost its discretion to avoid an obligation. Losing its discretion to avoid an obligation would occur if it has acknowledged and indicated it will act upon its decision to accept responsibility for an obligation and has sufficiently communicated its decision to affected parties. Evidence that the government has done so may exist before formal authorization of a transfer is in place. This standard effectively broadens the definition of a liability to include obligations that result from transactions and events beyond those relating to agreements, contracts, and existing legislation.

TRANSFER-PAYMENT ACCOUNTING PRACTICES

PSAB has proposed for discussion a new standard for accounting for government transfers by both transferring and recipient governments at the federal, provincial, territorial, and municipal levels. This standard could have a significant impact on the province as over 50% of the Ontario government's expenditures are transfer payments or grants to organizations such as hospitals, school boards, children's aid societies, and others. One of the more difficult issues this proposed standard deals with is multi-year funding—that is, funding that is provided in advance of the years the funds will actually be spent to provide services to the public. The main issue is whether 100% of the funds transferred should be recognized as an expense in the year of the transfer or be recognized as an expense only when the funds are actually spent by the recipient organization providing services to the public.

The discussion draft proposes that, in certain circumstances, a government that pays a transfer in advance of the recipient needing the funds to provide services would record the transfer as an asset. Recognition as an asset is justified where the transferring government has the right to compel the recipient to provide services or acquire or develop service capacity in accordance with the transferring government's terms.

In order for the government to treat a transfer as an asset, the government must stipulate, through a "specific purpose restriction," the nature of the future economic benefit it will acquire. In addition, the specific purpose restriction(s), time requirement(s), and accountability requirements must together describe the means through which the transferring government controls that benefit. In the absence of any one of these stipulations, the government may not treat the transfer as an asset and the entire amount of the transfer would be expensed.

Another significant proposal deals with what are known as "constructive obligations" and whether they should be recognized as liabilities. Constructive obligations arise when a government action raises valid expectations for other parties. For example, the government may publish its intention to grant funds to a certain group of individuals provided they meet certain eligibility requirements, raising an expectation that the group will receive funding if eligible. In contrast with the new liability standard discussed above, the draft proposes that constructive obligations for government transfers do not meet the definition of a liability and should not be recognized as such in government financial statements. The proposed standard specifies that the actions of the executive arm of the government alone would not create a binding obligation for the government that would qualify for recognition as a liability. The standard proposes that only the actions of the Legislature can impose a binding obligation on the government. The authorizing legislation, regulations or by-laws would have to be in place (that is, formally approved) by the financial statement date, and the exercise of authority under that legislation or those regulations or by-laws would have to have occurred by the financial statement date in order for a transfer to be recognized as a liability. This would be a change from the practice currently being followed.

STABILIZATION FUNDS AND FINANCIAL RESERVES

In March 2004, PSAB approved a guideline to clarify the appropriate presentation by federal, provincial, and territorial governments of information relating to stabilization funds and financial reserves. Funds and reserves, which take a variety of forms, are often used as a mechanism for managing government finances. Although they are not so used in Ontario, funds and reserves are currently used by certain other senior governments. The guideline clarifies that funds and reserves should not be presented on the government's statement of financial position. Governments that choose to provide information about such funds and reserves should do so only in the notes to the financial statements. Funds and reserves should have no impact on the government's measurement and presentation of its current or accumulated surplus or deficit.

CLARIFICATION OF GAAP

In June 2004, PSAB issued an Exposure Draft proposing a new standard on generally accepted accounting principles (GAAP). This standard would clarify what constitutes GAAP for the public sector and replace existing material in the Public Sector Accounting Handbook relating to what other accounting guidance should be considered when a particular accounting issue is not addressed within the Handbook itself. One of the main changes would be to remove current Canadian public-sector practice as a primary source of GAAP.

INFORMATION ON MEASUREMENT UNCERTAINTY

Also in June 2004, PSAB approved an Exposure Draft on measurement uncertainty. While the private-sector standard on measurement uncertainty applies only to items recognized on the face of the financial statements, this proposed public-sector standard would also require measurement uncertainty information when significant amounts are disclosed only in financial statement notes, as occurs with certain contingent liabilities.

DISCLOSURE OF INFORMATION ON BUSINESS SEGMENTS

PSAB has also begun a project on segment disclosures. Examples of segments include health care, education, and social services. The project is expected to result in a new standard requiring that additional financial information with respect to the distinct businesses or activities the government is engaged in be disclosed. The project has been undertaken because concerns have been raised about the level of aggregation of government summary financial statements—such aggregation may not provide

sufficiently detailed information to users about the specific activities governments engage in. As well, since the new definition of the reporting entity is expected to increase the number of organizations in the reporting entity, there is a perceived need to help users of financial statements better understand the different types of activities that the government is engaged in.

FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

In March 2004, PSAB also approved a Statement of Recommended Practice (Practice Statement) for Financial Statement Discussion & Analysis (FSD&A). The Practice Statement provides guidance for the presentation of FSD&A information in a government's financial report. This information would include narrative explanations and graphic illustrations of what happened in the period, highlighting the key relationships among the quantitative data set out in the financial statements, as well as explanations and illustrations of variances and trends. The Practice Statement sets out the qualitative characteristics upon which the FSD&A information should be based and suggests minimum requirements for FSD&A contents. We noted that the government updated its Annual Report this year to reflect the recommendations of this Practice Statement.

PERFORMANCE REPORTING

A project has also begun that is intended to result in a new Statement of Recommended Practice for reporting on performance. The project has been undertaken to help provide some consistency in performance reporting, as there is currently no national, generally accepted approach to the development of overall performance measurement and reporting in the public sector. The project is designed to develop a set of basic overarching principles that will guide the future development of performance reporting, including a framework for identifying specific performance indicators.

PROPOSED REVIEW OF PRE-ELECTION FINANCIAL REPORTS

As discussed in Chapter Two, the government tabled Bill 84, an Act to provide for fiscal transparency and accountability, in May 2004. Among other things, this proposed legislation would repeal the *Balanced Budget Act, 1999* and require that the government:

- seek to maintain a prudent ratio of provincial debt to Ontario's gross domestic product;

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- plan for a balanced budget unless, as a result of extraordinary circumstances, the government determines that incurring a deficit is consistent with prudent fiscal policy;
 - develop a recovery plan for achieving a balanced budget in future whenever a deficit is planned;
 - release a multi-year fiscal plan in the budget papers, periodically update this information, and make it available to the public;
 - establish an advisory body to give the Minister of Finance advice relating to the budget and fiscal plan; and
 - in circumstances to be prescribed by regulation, release a pre-election report on Ontario's finances, to be reviewed by the Provincial Auditor.

The pre-election report is to include the macroeconomic forecasts and assumptions used to prepare the fiscal plan, a description of any significant differences from those forecasts and assumptions, an estimate of Ontario's revenues and expenses, including its major components, information about the ratio of provincial debt to Ontario's gross domestic product, and details on the reserve required to provide for unexpected adverse changes in revenues and expenses. Under this proposed legislation, the Provincial Auditor's mandate would be to determine whether the government's pre-election report is reasonable and to release a statement prior to the election describing the results of our review.

We wrote to the Ministry of Finance in May 2004 regarding our proposed role with respect to the pre-election report and offered some suggested revisions to the proposed bill that in our view would clarify our role. As well, it will be essential that the pre-election report is prepared in time to allow us sufficient time to conduct our review.

OTHER MATTERS

The Provincial Auditor is required under section 12 of the *Audit Act* to report on any Special Warrants and Treasury Board Orders issued during the year or any failure to obtain them where required. In addition, under section 91 of the *Legislative Assembly Act*, the Provincial Auditor is required to report on any transfers of money between items within the same vote in the Estimates of the Office of the Legislative Assembly.

LEGISLATIVE APPROVAL OF GOVERNMENT EXPENDITURES

Shortly after presenting its budget, the government tables in the Legislature detailed Expenditure Estimates, outlining each ministry's spending proposals on a program-by-program basis. Commencing this fiscal year, the Estimates were to be prepared on the

accrual basis of accounting (in previous years, the Estimates were prepared on the modified cash basis of accounting). The Standing Committee on Estimates 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 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 as 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, 2004 received royal assent on December 18, 2003.

Typically, funds are required by ministry programs before the Supply Act is passed, and the Legislature authorizes these payments by means of motions for interim supply. For the 2003/04 fiscal year, the time periods covered by the motions for interim supply and the dates that the motions were agreed to by the Legislature were as follows:

- April 1, 2003 to September 30, 2003—passed June 24, 2003; and
- October 1, 2003 to March 31, 2004—passed November 24, 2003.

As the above motions of interim supply were both passed after the first day of the period covered, expenditures incurred before the motion date needed to be covered by a Special Warrant. As discussed in the next section, a Special Warrant totalling \$36.3 billion was passed on March 26, 2003. This warrant authorized expenditures between April 1, 2003 and June 24, 2003 and between October 1, 2003 and November 24, 2003.

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 the issue 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.

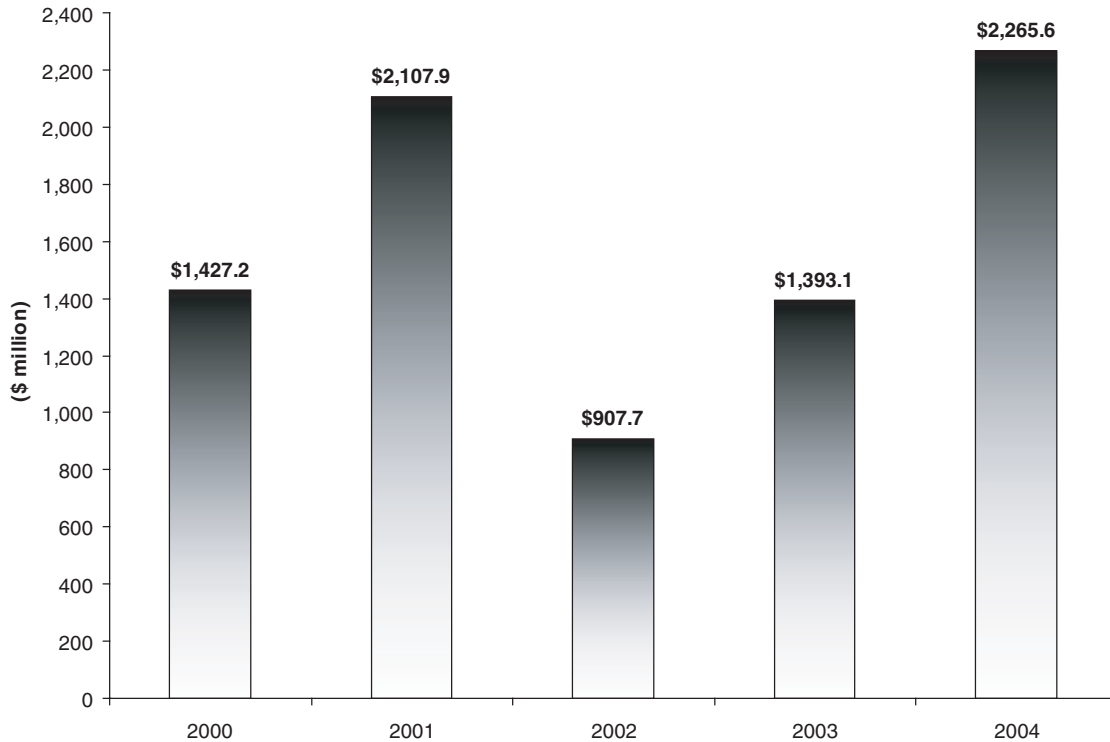
Two Special Warrants were issued for the fiscal year ended March 31, 2004. These Special Warrants, totalling \$36,323,185,100, were approved and ordered by an Order-in-Council dated March 26, 2003. They authorized expenditures both for the government and for the Office of the Chief Election Officer, the Provincial Auditor, the Legislative Assembly, and Ombudsman Ontario for the fiscal year commencing on April 1, 2003.

The total expenditures approved by the *Supply Act, 2003* excluded the amounts authorized by these Special Warrants.

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 insufficient to carry out the purpose for which it was made. 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 following chart is a summary of the total value of Treasury Board Orders issued for the past five fiscal years.



Treasury Board Orders for the 2003/04 fiscal year summarized by month of issue are as follows.

Month of Issue	Number	Authorized (\$)
May 2003–February 2004	50	1,007,215,133
March 2004	20	1,126,638,600
April 2004	10	115,618,500
May 2004	3	16,133,700
Total	83	2,265,605,933

According to the Standing Orders of the Legislative Assembly, Treasury Board Orders are to be printed in *The Ontario Gazette*, together with explanatory information. However, we noted that the most recent Orders printed in the Gazette were those that were issued for the 2000/01 fiscal year. A detailed listing of 2003/04 Treasury Board Orders, showing the amounts authorized and expended, are included as Exhibit Three of this report.

EXCEEDED APPROPRIATIONS

Section 12(f)(ii) of the *Audit Act* requires that we report on any cases where essential records were not maintained or the rules and procedures applied were not sufficient to ensure that expenditures were made only as authorized. Based on this year's audit of the summary financial statements and on information received from the Ministry of Finance, we noted that the actual expenses incurred and charged to the accounts for the fiscal year ended March 31, 2004 exceeded the legislative appropriations for seven Vote/Items across five ministries. These are detailed in the table below.

Ministry	Vote/Item	Actual (\$)	Appropriations (\$)	Exceedance (\$)
Attorney General	306-3	44,982,132	21,568,300	23,413,832
Consumer and Business Services	802-2	56,075,409	55,634,700	440,709
Management Board Secretariat	1805-2	501,757,616	296,874,000	204,883,616
Public Safety and Security	2604-1	109,364,354	106,018,000	3,346,354
Public Safety and Security	2606-1	75,742,084	75,730,300	11,784
Transportation	2702-1	16,608,377	13,459,800	3,148,577
Transportation	2704-2	170,261,775	135,701,000	34,560,775
Total		974,791,747	704,986,100	269,805,647

The main reasons for the three most significant exceedances are as follows:

- The Ministry of the Attorney General exceedance of \$23,413,832 occurred because of the need to accrue for expenses for payment orders awarded by the Criminal Injuries Compensation Board for both the 2003/04 fiscal year and prior fiscal years, which had not yet been paid as of the fiscal year end.

- The Management Board Secretariat exceedance of \$204,883,616 occurred because valuations on the pension plans and other benefits such as vacation pay and legislated severance were not finalized until after the fiscal year end.
- The Ministry of Transportation exceedance of \$34,560,775 occurred because the Ministry became aware of a requirement to accrue a transfer-payment expense relating to the disposal of highway assets and because of the need to reclassify certain vehicle fleet expenses from capital assets to capital expenses.

We were informed by the Ministry of Finance that, in all these cases, by the time the ministries become aware of the required adjustments, there were insufficient funds available in the Vote and Item to cover the amounts required. We were further informed by the Ministry of Finance that, although all three ministries had underspent funds available in other Voted Appropriations to offset these exceedances, existing legislation did not permit them to utilize the funds in the underspent Voted Appropriation to offset these exceedances through a Treasury Board Order.

Since legislative authority is required for all government expenditures, traditionally exceedances of this nature have been extremely rare. As discussed earlier, this year, for the first time, Ontario's Expenditure Estimates, and thus its appropriations, were prepared on the accrual basis of accounting. Accruals add a level of complexity to the accounting process, since accruals may be required to reflect expenditures incurred and liabilities owing where no payments have yet been made. Under the government's previous appropriation control system, only actual government payments were charged to appropriations. The increased complexity and the lack of experience with the new accrual system throughout the government undoubtedly contributed to the above exceedances.

Notwithstanding the significant changes that occurred in the 2003/04 fiscal year, exceeding Voted Appropriations is a serious matter. It is imperative that the Ministry of Finance work with Management Board Secretariat and all ministries over the next year to ensure that such exceedances do not reoccur.

In this regard, we understand that the Ministry of Finance is working on proposed amendments to the *Financial Administration Act* and the *Treasury Board Act* that would allow a charge against an appropriation if there are amounts available before the Public Accounts are released. This would permit post-year-end Treasury Board Orders in future fiscal years to address exceedances like those above. The proposed amendments would also retroactively provide the required spending authorization for this year's seven exceedances.

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 the Provincial Auditor make special mention of the transfer in our Annual Report.

With respect to the 2003/04 Estimates, the following transfers were made within Vote 201:

From:	Item 3	Legislative Services	\$	265,900
To:	Item 2	Office of the Clerk		265,900
From:	Item 5	Administrative Services		372,000
To:	Item 6	Sergeant at Arms and Precinct Properties		372,000
From:	Item 10	Members' Office Support Services		1,192,100
To:	Item 8	Caucus Support Services		1,192,100

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 to be uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2003/04 fiscal year, receivables of \$214 million due to the Crown from individuals and non-government organizations were written off (in 2002/03, the comparable amount was \$84.8 million). Volume 2B of the 2003/04 Public Accounts summarizes these write-offs by ministry.

Under the accounting policies followed in the audited financial statements of the province, a provision for doubtful accounts is recorded against accounts receivable balances. Accordingly, most of the \$214 million in write-offs had already been provided for in the audited financial statements. However, the actual deletion from the accounts required Order-in-Council approval.

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

- \$76.9 million for uncollectible corporate taxes;
- \$56.6 million for uncollectible retail sales taxes;
- \$47.2 million for uncollectible fines or court fees;
- \$7.2 million for uncollectible employer health taxes;
- \$6.2 million for uncollectible receivables under the Ontario Disability Support Program; and
- \$5.6 million for uncollectible receivables under the Student Support program.