Chapter 2

Public Accounts of the Province

1.0 Summary

This year, the audit opinion on the Province's consolidated financial statements is unqualified, or "clean." Based on our audit work, we have concluded that the statements for the 2017/18 fiscal year are fairly presented and free from material errors.

The issuance this year of an unqualified audit opinion is significant in light of the fact that we issued qualified opinions in the previous two years. An unqualified opinion confirms that the consolidated financial statements accurately present the Province's financial position and results for the year ended March 31, 2018.

This year's unqualified opinion came after the current government made appropriate changes to the Province's financial statements in two key areas to comply with Canadian public sector accounting standards (PSAS) as follows:

- It recorded a full valuation allowance on the net pension assets relating to the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan to reflect that it has no legal authority to draw on the assets as at March 31, 2018.
- It excluded the Independent Electricity System Operator (IESO) market accounts from the Province's consolidated financial position in 2017/18 and restated the comparative 2016/17 balances. In addition, in 2016/17 the government reversed the inappropriate use of rate-regulated accounting in connection with certain balances recorded by the IESO in connection with Ontario's electricity rate reduction.

Canadian PSAS are the most appropriate standards for the Province to use in preparing its consolidated financial statements because they ensure that information about the surplus and the deficit is fair, consistent, and comparable to data from previous years and from peer governments. This allows legislators and the public to better assess government management of public finances.

In **Chapter 2** of our *2016* and *2017 Annual Reports*, we discussed the government's use of external advisors to provide accounting analysis, advice and interpretation. We also highlighted that the interests of Treasury Board Secretariat, the Ministry of Finance and the Office of the Auditor General are best served when the work of external advisors is brought to our attention and discussed on a timely basis when it impacts the consolidated financial statements of the Province in current and future years.

We continue to recommend that Treasury Board Secretariat notify our Office and request our input when a private-sector accounting firm provides accounting advice to the government, and that the Secretariat consult with us when a government agency or organization plans to engage and/or retain the same private-sector accounting firm for both accounting advice and auditing services.

In **Chapter 2** of our *2017 Annual Report*, we recommended that our Office conduct an attest audit of the December 31, 2017, financial statements of the IESO. In early 2018, we undertook and completed a special audit of the IESO. Unfortunately, we encountered a pattern of atypical pushback on our audit inquiries from the IESO Board.

In order to perform our work, we require certain information on all of our attest audits. The IESO consistently refused to provide us with written acknowledgement of their roles and responsibilities with respect to our audit; nor would management sign a representation letter confirming that they had provided us with all relevant information that may affect the financial statements. As a result of these refusals, we issued a disclaimer of opinion as required by Canadian Auditing Standards.

In our letters to the Standing Committee on Public Accounts on March 20, 2018, and April 11, 2018, we highlighted significant issues with the IESO's financial statements that could potentially impact the Province's consolidated financial statements.

Another of our statutory responsibilities relates to the *Fiscal Transparency and Accountability Act, 2004* (Act). The Act requires the government to issue a pre-election report on the province's finances ahead of a provincial election, and it requires our Office to review that report.

In April 2018, we tabled our report titled *Review of the 2018 Pre-Election Report on Ontario's Finances* (Pre-Election Report) in accordance with the Act. The Pre-Election Report was the third issued in Ontario (the first two were issued in 2007 and 2011).

Between 2004, when the Act was passed, and 2016, the fixed election date was set as the first Thursday in October, every four years. However, the *Election Statute Law Amendment Act, 2016* was passed in December 2016 to move the fixed election date to the first Thursday in June, every four years, to ensure the fixed provincial election date would not overlap with Ontario's municipal election dates. The impact of this amendment was to reduce by 17 weeks the time between the issuance of the Pre-Election Report and the fixed election date. Our Office completed our review with the co-operation of staff at the Ministry of Finance and Treasury Board Secretariat, along with various other ministries.

The Province's growing debt burden (without plans to manage it) also remains a concern this year, as it has been since we first raised the issue in 2011. This year, we again focus on the critical implications for the Province's finances of the growing debt. The Province should provide legislators and the public with long-term targets for addressing Ontario's current and projected debt.

This chapter contains three recommendations, consisting of four actions, to address our observations.

2.0 Background

Ontario's Public Accounts for the fiscal year ending March 31, 2018, were prepared under the direction of the Minister of Finance, as required by the *Financial Administration Act*, and the President of the Treasury Board. The Public Accounts consist of the Province's Annual Report, including Ontario's consolidated financial statements, and three supplementary volumes of additional financial information.

The government is responsible for preparing the consolidated financial statements for the Province, and for ensuring that this information, including many amounts based on estimates and judgment, is presented fairly. The government is also responsible for ensuring that an effective system of internal controls, with supporting procedures, is in place to authorize transactions, safeguard assets and maintain proper records.

Our Office, under the *Auditor General Act*, is responsible for the annual audit of these consolidated financial statements. The objective of our audit is to obtain reasonable assurance that the statements are free of material misstatements—that is, free of significant errors or omissions. The consolidated financial statements, along with the Auditor General's Independent Auditor's Report, are included in the Province's Annual Report.

The Province's Annual Report also contains a Financial Statement Discussion and Analysis (FSD&A) section that provides additional information regarding the Province's financial condition and fiscal results. This additional information is intended to enhance 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—unaudited statements from all ministries and a number of schedules providing details of the Province's revenue 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 audited financial statements; and
- Volume 3—detailed unaudited schedules of ministry payments to vendors and transfer-payment recipients.

Our Office reviews the information in the FSD&A, and in Volumes 1 and 2 of the Public Accounts, for consistency with the information presented in the Province's consolidated financial statements.

The *Financial Administration Act* requires that, except in extraordinary circumstances, the government deliver its Annual Report to the Lieutenant Governor in Council within 180 days of the end of the fiscal year. The deadline for the 2017/18 fiscal year was September 27, 2018. The three supplementary volumes must be submitted to the Lieutenant Governor in Council within 240 days of the end of the fiscal year. Upon receiving these documents, the Lieutenant Governor in Council must lay them before the Legislative Assembly or, if the Assembly is not in session, make the information public and then lay it before the Assembly within 10 days of the time it resumes sitting.

This year, the government released the Province's 2017/18 Annual Report and Consolidated Financial Statements, along with the three Public Accounts supplementary volumes, on September 21, 2018, meeting the legislated deadline.

The Auditor General's audit opinion on the Province's consolidated financial statements was unqualified for the first time in three years because the current government corrected the accounting issues that were of past concern (the incorrect treatment of certain pension plans' surpluses and the improper accounting design of the global adjustment refinancing portion of the electricity rate reduction).

An unqualified opinion means that the consolidated financial statements are free from material errors. The unqualified audit opinion is discussed in **Section 3.0** below.

3.0 The Province's 2017/18 Consolidated Financial Statements

3.1 Auditor's Responsibilities

As the legislature's independent auditor of the Province's consolidated financial statements, the Auditor General's objective is to express an opinion on whether the financial statements are free of material misstatements and are prepared in accordance with Canadian PSAS so that they give a true and fair view of the financial position and results of the Province. It is this independence, combined with the professional obligation to comply with established Canadian Auditing Standards and relevant ethical requirements, that allows the Auditor General to issue an opinion that provides users with confidence in the Province's consolidated financial statements.

To enable the Auditor General to form her opinion, our Office collects sufficient appropriate audit evidence and evaluates it to determine whether the financial statements are free of material misstatements. This includes assessing the government's preferred accounting treatment over certain transactions, and analyzing the appropriateness of those treatments under Canadian PSAS.

An assessment of what is material (significant) and immaterial (insignificant) is based primarily on our professional judgment. In making this assessment, we seek to answer the following question: "Is this error, misstatement or omission significant enough that it could affect decisions made by users of the Province's consolidated financial statements?" If the answer is yes, then we consider the error, misstatement or omission as material.

To help us make this assessment, we determine a materiality threshold. This year, as in past years and consistent with most other auditors in provincial jurisdictions, we set our threshold at 0.5% of the greater of government expenses or revenue for the year.

Our audit is conducted on the premise that management has acknowledged certain responsibilities that are essential to the conduct of the audit in accordance with Canadian Auditing Standards. These responsibilities are discussed below.

3.2 Management's Responsibilities

The auditor's report distinguishes between the responsibilities of management and of the auditor with respect to a financial-statement audit. Management (for the Province, that is, Treasury Board Secretariat and the Ministry of Finance, with support from the Office of the Provincial Controller Division) is responsible for the preparation of the financial statements in accordance with Canadian PSAS. The auditor examines the financial statements in order to express an opinion as to whether they have been prepared in accordance with Canadian PSAS. The division of responsibility between management and the auditor is fundamental and preserves the auditor's independence, a cornerstone of the auditor's report.

In addition to preparing the financial statements and having the relevant internal controls, management is also required to provide the auditor with all information relevant to the preparation of the financial statements, additional information that the auditor may request, and unrestricted access to individuals within the entity who the auditor determines are necessary to obtain audit evidence. Canadian Auditing Standards are clear on these requirements, and the fulfillment of these is formally communicated to the auditor in the form of a signed management-representation letter at the end of the audit.

When a transaction occurs, it is management's responsibility to identify the applicable accounting standards, determine the implications of the standards on the transaction, decide on an accounting policy and ensure that the financial statements present the transaction in accordance with the applicable financial reporting framework (for example, Canadian PSAS for governments). The auditor must also be proficient in the applicable financial reporting framework in order to form an independent opinion on the financial statements, and may perform similar procedures in identifying the applicable standards and understanding the implications of the standards on the accounting transaction. However, unlike management, the auditor does not select an accounting policy or the bookkeeping entries for the organization. These decisions are in the hands of management.

When there are disagreements between an auditor and management on the application or adequacy of accounting policies, the auditor must assess the materiality or significance of the issue to the overall financial statements in forming the audit opinion. If the issue is material, it would result in a qualified opinion in which the auditor concludes that the statements are fairly presented except for the items described in the basis for the qualification.

The Office of the Auditor General may make suggestions about the consolidated financial statements but this does not change management's responsibility for the statements. Similarly, the government may seek external advice on accounting treatments of certain transactions. In such situations, the government still has the ultimate responsibility for the decisions made, and the use of external advisors does not diminish, change or replace the government's accountability as the preparer of the Province's consolidated financial statements.

3.3 The Independent Auditor's Report

The auditor's report, which is issued at the conclusion of an audit engagement, comprises:

- an introductory paragraph that identifies the financial statements audited;
- a description of the responsibility of management for the proper preparation of the financial statements in accordance with the applicable financial reporting framework;
- a description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit; and
- an opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.

The auditor's report may further include:

- an Emphasis of Matter paragraph that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements; and
- an Other Matter paragraph that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

3.4 The Significance of an Unqualified Audit Opinion

The independent auditor's report is how the auditor communicates their opinion to users of the financial statements as to whether the statements of an entity are presented fairly. After the audit of the financial statements is completed, the auditor can sign one of four possible opinions:

- **Unqualified, or clean, opinion:** The financial statements present fairly, in all material respects, the financial position and results of the entity.
- **Qualified opinion:** The statements contain one or more material misstatements or omissions.
- **Adverse opinion:** The statements do not fairly present the financial position, results of operations and changes in financial position, as per Canadian generally accepted accounting principles.
- **No opinion or disclaimer of opinion:** It is not possible to give an opinion on the statements because, for example, key records of the entity were destroyed and thus unavailable for examination.

An *unqualified* audit opinion indicates that the financial statements are reliable. For the first time in three years, the Office of the Auditor General has issued an unqualified opinion on the Province's consolidated financial statements. As a result of the corrections it made, the government is now in full compliance with Canadian PSAS. The consolidated financial statements can be relied on to fairly and accurately present the Province's fiscal results for the year ended March 31, 2018, in all material respects.

3.5 The 2017/18 Audit Opinion

The *Auditor General Act* requires that we report annually on the results of our examination of the Province's consolidated financial statements. The Independent Auditor's Report to the Legislative Assembly on the Province's consolidated financial statements for the year ended March 31, 2018, is reproduced on the following page.

Office of the Auditor General of Ontario
Bureau de la vérificatrice générale de l'Ontario

INDEPENDENT AUDITOR'S REPORT

To the Legislative Assembly of the Province of Ontario

I have audited the accompanying consolidated financial statements of the Province of Ontario, which comprise the consolidated statement of financial position as at March 31, 2018, and the consolidated statements of operations, change in net debt, change in accumulated deficit and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

The Government of Ontario (Government) is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as Government determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Government, as well as evaluating the overall presentation of the consolidated financial statements.
I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Province of Ontario as at March 31, 2018, and the consolidated results of its operations, change in its net debt, change in its accumulated deficit and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Toronto, Ontario
September 12, 2018

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Auditor General

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3.6 Independent Financial Commission of Inquiry

In July 2018, the newly elected government announced the creation of an Independent Financial Commission of Inquiry (Commission). The Commission's mandate was to look into the former government's accounting practices and provide the new government with advice and recommendations going forward. In its report to the government on August 30, 2018, the Commission made several recommendations to the government.

In the Province's consolidated financial statements for the year ended March 31, 2018, the government appropriately made significant accounting changes that were required to present the statements in accordance with Canadian PSAS and consistent with the recommendations in the Commission's report.

The accounting changes included:

- recognition of a full valuation allowance against the pension assets for both the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan;
- discontinuation of the use of rate-regulated accounting in connection with Ontario's electricity rate reduction; and
- recording the full financial impact of the Fair Hydro Plan.

Although not included as a recommendation in the Commission's report, the government removed the IESO electricity market account assets and liabilities from the consolidated financial statements to be in accordance with Canadian PSAS.

The impact of the above changes are discussed further in **Section 3.7** below.

3.7 Changes to the Consolidated Financial Statements

3.7.1 Net Pension Assets and the Consolidated Financial Statements

As at March 31, 2018, the government reported pension assets before any valuation allowance from the Ontario Teachers' Pension Plan (OTPP) of $13.635 billion (2016/17 – $11.511 billion) and from the Ontario Public Service Employees' Union Pension Plan (OPSEUPP) of $1.014 billion (2016/17 – $0.918 billion), for a total of $14.649 billion (2016/17 – $12.429 billion).

In order to comply with Canadian PSAS, a full valuation allowance against these assets in pension plans the government co-sponsors with its employees should be recorded to reflect that the government does not have the unilateral right to reduce its minimum contributions or withdraw surplus without reaching a formal agreement with the plans' other joint sponsors. We concluded that the government did not have a legally enforceable right to benefit from the pension assets because agreements with the other joint sponsors were not obtained in 2015/16. We arrived at the same conclusion in 2016/17 and 2017/18.

The Commission's report recommended the government "[a]dopt the Auditor General's proposed accounting treatment for any net pension assets of the Ontario Teachers' Pension Plan and Ontario Public Service Employees' Union Pension Plan on a provisional basis, until an agreement is reached between the government and the Auditor General. For the Public Accounts of Ontario 2017/18, this included restatement of the prior year's figures for comparative purposes." The government accepted and implemented the Commission's recommendation.

As a result, a full valuation allowance was taken against the pension assets of OTPP and OPSEUPP in the consolidated financial statements of the Province as at March 31, 2018. In accordance with the Commission's recommendation and Canadian PSAS, the prior year's comparative figures were also restated to take a full valuation allowance in 2016/17.

The adjustments to the consolidated financial statements with respect to the two pension plans reduced the net pension assets reported on the consolidated statement of financial position for 2017/18 by $14.649 billion (2016/17 – $12.429 billion), resulting in a net pension liability of $0.855 billion (2016/17 – $1.396 billion) being reported. This is illustrated in **Figure 1** and disclosed in Notes 6 and 19A to the 2017/18 consolidated financial statements of the Province. The effect of recording the full valuation allowance against the pension assets for the OTPP and the OPSEUPP on the consolidated statement of operations was to increase the Province's reported annual deficit for 2017/18 by $2.220 billion (2016/17 – $1.444 billion).

3.7.2 Exclusion of IESO's Market Accounts from the Consolidated Financial Statements

We also qualified our audit opinion on the Province's consolidated financial statements in 2016/17 because the Province inappropriately recorded market account assets and liabilities (which are not assets and liabilities of either the IESO or the Province).

The IESO operates the Province's electricity market, and the market account assets and liabilities cover the amounts the IESO collects from local distribution companies and pays to power generators, respectively.

The Province has no access or discretionary power to use the market account assets for its own benefit; nor does the Province have an obligation to settle the market account liabilities in the event of default by market participants. As such, the market accounts do not meet the criteria for recognition as assets and liabilities in the Province's consolidated financial statements.

The government removed the IESO electricity market account assets and liabilities from the consolidated financial statements to be in accordance with Canadian PSAS, even though this was not included as a recommendation in the Commission's report. On this issue, the Commission recommended the government "[a]dopt the Auditor General's proposed accounting treatment for global adjustment refinancing, which is a major component of the Fair Hydro Plan." The government excluded the IESO market accounts from the Province's consolidated statement of financial position in 2017/18 and restated the comparative 2016/17 period for the same. The change in accounting and prior year restatement was disclosed in Note 19B to

Figure 1: Pension Asset (Liability) as at March 31, 2018

Sources of data: March 31, 2018, Province of Ontario Consolidated Financial Statements and the Office of the Auditor General of Ontario

	2018 Pensions ($ million)	2017 Pensions ($ million)
Obligation for benefits	133,854	124,700
Less: plan fund assets	(162,600)	(149,851)
Obligation over/(under) plan assets	**(28,746)**	**(25,151)**
Unamortized actuarial gains	14,707	14,104
Accrued pension asset	**14,039**	**11,047**
Valuation allowance – OTPP	(13,635)	(11,511)
Valuation allowance – OPSEUPP	(1,014)	(918)
Valuation allowance – all other plans	(245)	(14)
Net pension asset (liability)*	**(855)**	**(1,396)**

* As presented in the March 31, 2018, Province of Ontario Consolidated Financial Statements.

the 2017/18 consolidated financial statements of the Province.

3.7.3 Discontinued Use of Rate-Regulated Accounting for Other Government Organizations

In 2016/17, we included an Other Matter paragraph in our audit opinion referring to the IESO's retroactive adoption of rate-regulated accounting. We noted then that although the adoption of rate-regulated accounting at the consolidated provincial level did not result in material misstatement in the Province's 2016/17 consolidated financial statements, the statements could become materially misstated in future as a result of the legislated accounting prescribed under the *Ontario Fair Hydro Plan Act, 2017*.

The IESO is classified as an Other Government Organization (OGO). Under provisions of Canadian PSAS, the financial results of an OGO must be conformed to Canadian PSAS prior to consolidation in the Province's consolidated financial statements. Rate-regulated accounting is not permitted when a government or a government-controlled OGO presents its financial statements in accordance with Canadian PSAS.

As noted, the Commission recommended the government adopt the Auditor General's proposed accounting treatment for the Fair Hydro Plan. The government accepted the recommendation and discontinued the use of rate-regulated accounting in connection with balances related to the global adjustment refinancing, and reversed all rate-regulated accounting balances recorded by the IESO in 2016/17, which were not yet material.

3.7.4 Changes to the Province's Financial Statement Discussion and Analysis (FSD&A)

In 2017/18, the government adjusted all current and historical figures in the Province's FSD&A to reflect full valuation allowances for the OTPP and OPSEUPP, the exclusion of IESO market accounts, and the reversal of rate-regulated accounting balances recognized in 2016/17 recorded in anticipation of the provisions of the *Fair Hydro Plan Act, 2017*.

These changes were made to ensure alignment with the corrected consolidated financial statements that would now be reported in accordance with Canadian PSAS and aligned with the recommendations of the Commission. As a result, no Other Matter paragraph was required in our 2017/18 audit opinion.

4.0 The Province's Use of External Consultants

In **Chapter 2** of our *2016* and *2017 Annual Reports*, we reported on the Province's use of external advisors to obtain accounting analysis, advice and interpretation.

We highlighted that the interests of Treasury Board Secretariat, the Ministry of Finance and the Office of the Auditor General are best served when there is full disclosure on the use of external advisors. For this reason, any work performed by external advisors should be shared with our Office as soon as possible, as part of the audit of the Province's consolidated financial statements. We recommended that the Treasury Board Secretariat provide our Office with copies of all contracts with external advisors so that we are aware of the scope of the work they perform, and can assess the impact on the annual audit. We also recommended that Treasury Board Secretariat incorporate in its contracts with external advisors a provision that the external advisors also notify our Office of their engagement with the Province.

We noted in our Special Audit of the 2017 financial statements of the IESO that in 2017/18, the IESO Board engaged the same private accounting firm both to perform the audit of the IESO's financial statements and to provide accounting advice relating to the design and implementation of the former government's Fair Hydro Plan at the IESO. Without sufficient safeguards, this can represent an inherent conflict of interest, as the role of an auditor is incompatible with that of an advisor to management. An auditor needs to perform their work serving the public interest, whereas an advisor acts in the best interests of management. In addition to being engaged to provide both audit and accounting advisory services, we found that the private accounting firm billed the IESO significantly more for accounting advice than for its annual auditing fee (see **Section 5.0** below). In situations like this, there is a risk that private accounting firms may not be able to maintain the independence, objectivity and professional skepticism needed to perform a high-quality audit.

Similarly, there may also be instances where external advisors can have a potential conflict of interest in providing the government and the public with independent advice. For example, in November 2016, the former government created the Pension Asset Expert Advisory Panel (Panel) and tasked it with providing independent advice on how to account for the net pension assets of the OTPP and the OPSEUPP. Just before the release of the Panel's first report in February 2017, one of the panel members entered into an agreement to provide actuarial consulting services to the government. The agreement contained a clause stating that the panel member's participation would not begin until after the completion of work for the Panel. Despite the clause, there is still an inherent risk that this additional work could influence the panel member's advice and impair their independence.

The Independent Financial Commission of Inquiry noted similar concerns in its report, which recommended that the government notify and seek comment from the Office of the Auditor General when ministries and agencies propose to engage external advisors to provide accounting advice. In addition, the report recommends that the Province consult our Office before approving retention of the same private-sector firm for both accounting advice and auditing services.

RECOMMENDATION 1

Recognizing that the Auditor General is appointed under the *Auditor General Act* as the auditor for the consolidated financial statements of the Province, we recommend that Treasury Board Secretariat:

- notify the Office of the Auditor General (Office) and request its comment when a ministry, government agency or Crown-controlled corporation consolidated into the financial statements of the Province proposes to engage an external advisor to provide accounting advice; and
- consult the Office when a government agency or Crown-controlled corporation plans to engage and/or retain the same external advisor for both accounting advice and auditing services.

TREASURY BOARD SECRETARIAT RESPONSE

The government engages external advisors throughout the year in various capacities that include providing accounting analysis, advice and interpretation. External advisors are generally engaged to provide advice and guidance to supplement internal analysis.

The interests of the Treasury Board Secretariat (Secretariat) and the Office of the Auditor General are best served when there is full disclosure on the intent and use of external advisors.

To further promote full disclosure, the Secretariat will evaluate options to support the proactive notification and consultation with the Office when ministries, consolidated agencies and Crown-controlled corporations propose to engage an external advisor for accounting advice.

5.0 Independent Electricity System Operator

5.1 Audit of the IESO for Fiscal Year 2018

The IESO recently communicated to us that it will appoint us as the attest auditors for the year ended December 31, 2018, and that it will be retroactively adjusting its 2016 and 2017 financial statements to remove the market accounts and to reverse the use of rate-regulated accounting. Its accounting policies will revert back to what they were in the audited financial statements for the year ended December 31, 2015.

We look forward to working with senior management of the IESO during the audit of its financial statements for the year ended December 31, 2018. We will provide an updated status in **Chapter 2** of our *2019 Annual Report*.

5.2 Challenges Encountered in Conducting the Special Audit of IESO

In early 2018, pursuant to section 9 of the *Auditor General Act* and subsection 25.2(2) of the *Electricity Act* and the above recommendation, we undertook and completed a special audit of the IESO financial statements for the year ended December 31, 2017. The audit was characterized by a pattern of atypical pushback on our inquiries from the IESO Board.

While the IESO stated that it would comply and fully co-operate with our special audit, there were several key instances of unusual and unco-operative behaviour that clearly suggested to us that the IESO was less than completely open and transparent.

At the start of the audit, the IESO Board did not support our conducting the financial statement audit for this period instead of KPMG LLP (their incumbent external auditor) or through a joint audit with KPMG. Therefore, we conducted our work separately but simultaneously with KPMG's audit of IESO's December 31, 2017, financial statements.

During the audit, the IESO designated an individual as the IESO's audit co-ordinator. This individual was to attend all meetings between IESO staff and our auditors to record conversations, comments, and all audit requests, regardless of the sensitivity or confidentiality of the topics (for example, executive compensation or employee Human Resources records). In a discussion with another IESO employee, we became aware that staff were instructed not to send audit requests directly to our auditors based on an internal protocol established by the IESO. All requests were funnelled through the audit co-ordinator. The normal role of an audit co-ordinator is to provide the auditors with the appropriate contacts within the organization, set up initial meetings with those contacts and track down information requests if the information is not being provided in a timely fashion.

The chairs of the Board and Audit committees wrote us several letters conveying the message that they would co-operate, while maintaining that they would not sign key documents we needed to complete our audit in accordance with Canadian Auditing Standards. These documents, including the audit planning report and a letter of representation, are a formal acknowledgment by the IESO Board and management of their roles and responsibilities, and that they have provided us with all relevant information with respect to a financial statement audit. The IESO provided these standard acknowledgements to KPMG.

Toward the finalization of the audit, and despite numerous requests from our office to attend the Board meeting to approve the financial statements, the IESO indicated that they did not know when the meeting would be held. Our subsequent repeated requests received no responses. The IESO did not inform us of the date until after the Board meeting had taken place—and KPMG had issued an unqualified (clean) opinion on IESO's financial statements for the year ended December 31, 2017. In effect, the Board did not allow us to attend the meeting where it approved the financial statements of the IESO. KPMG, however, was in attendance.

An additional aspect of the unprecedented accounting and auditing situation at the IESO was the comprehensive legal protection that IESO sought and obtained for its staff. An agreement signed by the Minister of Energy between the IESO and the Province, effective June 1, 2017, indemnified the IESO, its directors, officers and employees from a comprehensive list of possible actions against them, specifically in connection with the Fair Hydro Plan. This was highly unusual, and we are not aware of prior comprehensive indemnity agreements on any other specific accounting issue. We later learned that a similar indemnity agreement related to the Fair Hydro Plan was signed for Ontario Power Generation, its directors, officers and employees.

5.3 Results of the Special Audit of IESO for the Fiscal Year 2017

We reported on the results of our special audit of the financial statements of the IESO for the year ended December 31, 2017, to the Standing Committee on Public Accounts in letters dated March 20 and April 11, 2018. Our final Independent Auditor's Report to the IESO and the Standing Committee is reproduced on the following pages.

In order for us to perform our work in accordance with Canadian Auditing Standards, we require certain information on all of our audits. However, as noted in **Section 5.1** of this report, the IESO consistently refused to provide us with written acknowledgement of their roles and responsibilities with respect to our audit (all the while insisting in correspondence that they were co-operating); nor would management sign a representation letter confirming that they had provided us with all relevant information that may affect the financial statements.

As a result of these refusals, we were unable to provide an audit opinion on the IESO's financial statements under professional auditing standards. We did, however, provide a disclaimer of opinion in our Independent Auditor's Report.

In our letters to the Standing Committee on Public Accounts, we highlighted significant issues with the IESO's financial statements and other items that had the potential to impact the Province's consolidated financial statements. These issues included:

- a lack of co-operation;
- the inappropriate inclusion of rate-regulated assets and market accounts on the IESO's financial statements that would result in an understatement of the Province's annual deficit and net debt if not reversed upon consolidation;
- the material understatement of the IESO's unfunded benefit-plan liabilities due to the use of inappropriate discount rates;
- the IESO's initial failure to disclose, and its disclosure only in a subsequent financial statement revision, of a December 2017 pledge of the current and future receivables from local distribution companies (LDCs) as collateral for debt investors of the Fair Hydro Trust (meaning that if the IESO defaults on its payments of carrying costs to the Fair Hydro Trust, the money it receives from ratepayers through LDCs must be used to pay the Trust before power generators can be paid); and
- a clarification of the roles of KPMG LLP, Deloitte LLP, and Ernst & Young LLP with respect to the Fair Hydro Plan, because none of the work of the firms, individually or in aggregate, constituted an accounting opinion on the consolidated financial statements of the Province.

Office of the Auditor General of Ontario
Bureau de la vérificatrice générale de l'Ontario

INDEPENDENT AUDITOR'S REPORT

To the Independent Electricity System Operator and
The Standing Committee on Public Accounts of Ontario

Report on the Financial Statements

I have audited the accompanying financial statements of the Independent Electricity System Operator (IESO), which comprise the statement of financial position as at December 31, 2017, and the statements of operations and accumulated surplus, remeasurement gains and losses, changes in net debt, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with Canadian generally accepted auditing standards. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Management and those charged with governance refused to acknowledge their roles and responsibilities in my audit and they have failed to sign a management representation letter addressed to me to confirm that management has fulfilled their responsibilities for the financial statements. As a result of this refusal, I am unable to obtain assurance over the accuracy and completeness of information provided by and representations made to me by management and those charged with governance.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Other Matter

The financial statements of the IESO for the year ended December 31, 2016 were audited by another auditor who expressed an unqualified opinion on those financial statements on March 22, 2017.

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Report on Matters Arising from Special Audit

Auditor General Act

As the Auditor General, I have a responsibility under the Auditor General Act (Act) to report on matters that are significant to the consolidated financial statements of the Province of Ontario. When something of the magnitude, described below, affects the consolidated financial statements of the Province of Ontario, I am also responsible under the Act to take additional steps to understand and investigate the transactions.

Inappropriate Inclusion of Rate Regulated Assets and Market Accounts

As described in Notes 2d, 2e, 3, 5, 7 and 14c to these financial statements, the IESO has recognized rate regulated and market account assets and liabilities. IESO is considered an "other government organization" under Canadian public sector accounting standards. Rate regulated accounting is not permitted in an "other government organization" under Canadian public sector accounting standards and therefore, the regulated assets recognized by the IESO should not be recognized. The market accounts recognized track mainly buy and sell transactions between electricity market participants (electricity power generators and power distributors). These market accounts, as recorded on the financial statements are not assets and liabilities of the IESO. Under the current Market Rules, the IESO has no access or discretion to use the market account assets for its own benefit, nor does the IESO have an obligation to settle the market account liabilities in the event of default by market participants.

Beginning in July 2017, as part of its legislated role in the *Fair Hydro Plan Act, 2017*, the IESO incurs a shortfall arising from the difference between the amounts it collects from power distributors and it pays to contracted power generators. The electricity price ceiling imposed by the Fair Hydro Plan Act exposes the IESO to financial risk such that it is now responsible for obtaining financing to cover the shortfall in market settlement. To fund this legislated shortfall, the IESO receives advances from Fair Hydro Trust, a related party. At the same time, the IESO records the sale of a rate regulated asset to the Fair Hydro Trust in an amount equal to the shortfall, thereby removing the impact of the shortfall on the annual surplus and eliminating the obligation to the Fair Hydro Trust. This approach constitutes a departure from Canadian public sector accounting standards.

These departures will impact the Province's consolidated financial statements for the year ended March 31, 2018 unless corrected by the Province. Based on the transactions for the period up to December 31, 2017, the estimated impact on the Province's consolidated financial statements is as follows:

- Understatement of Annual Deficit by $1.353 billion
- Overstatement of Total Financial Assets by $2.045 billion
- Overstatement of Total Liabilities by $0.627 billion
- Understatement of Provincial Net Debt by $1.418 billion
- Overstatement of Ending Accumulated Surplus by $1.418 billion

Inappropriate Discount Rate Used on Unfunded Retirement Benefit Plans

As described in Note 2i to these financial statements, the IESO uses an expected return on plan assets as the discount rate to value all of its pension and other post-employment plan liabilities. IESO provides certain non-registered defined benefit pensions and other employee future benefits through two unfunded non-registered benefit plans. As these unfunded plans have no plan assets, it is inappropriate to use an expected rate of return on plan assets for the discount rate. In accordance with PSAS, the IESO should use a discount rate based on their cost of borrowing for these unfunded plans. If IESO had used a discount rate based on its estimated cost of borrowing, as at December 31, 2017, opening accumulated surplus would decrease by $53.2 million, benefit costs would increase by $1.9 million, and total liabilities would increase by $55.0 million.

Toronto, Ontario
April 5, 2018

Bonnie Lysyk, MBA, FCPA, FCA, LPA
Auditor General

5.4 Chapter 2 of our *2017 Annual Report*—IESO Reference

In **Chapter 2** of our *2017 Annual Report*, we outlined serious concerns about accounting changes made by the IESO for the year ended December 31, 2016. In particular, **Recommendation 5** of that chapter stated:

> *We recommend that the Independent Electricity System Operator (IESO), an "other government organization," use the Canadian Public Sector Accounting Standards (PSAS) in the preparation of its financial statements. Specifically, it should:*
>
> - *remove market accounts recorded on its financial statements; and*
> - *discontinue the inappropriate use of rate-regulated accounting in the preparation of its financial statements.*
>
> *To ensure that the members of the Legislative Assembly receive financial information on the operations of the IESO prepared in accordance with Canadian PSAS, the Office of the Auditor General will conduct an attest audit of the December 31, 2017, financial statements of the IESO as permitted under the* Electricity Act, *Subsection 25.2(2), which states: "The Auditor General may audit the accounts and transactions of the IESO."*

6.0 Review of 2018 Pre-Election Report

In April 2018, the Office of the Auditor General tabled its report titled *Review of the 2018 Pre-Election Report on Ontario's Finances* (Pre-Election Report) in accordance with the Fiscal Transparency and *Accountability Act, 2004* (Act).

The Act states that in such circumstances as may be prescribed by regulation, the Ministry of Finance (Ministry) shall release a Pre-Election Report about Ontario's finances in a fixed election year, and shall do so before the deadline established by the regulation. The same Act requires the Auditor General, after passage of the regulation, to review the Pre-Election Report and promptly release a report of her own outlining whether the government's fiscal projections are reasonable.

In February 2018, the government filed Ontario Regulation 41/18, which required that the Pre-Election Report be released within seven days of the introduction and first reading of the 2018 Budget bill. The government introduced its Budget bill on March 28, 2018, and released the Pre-Election Report the same day. The Act specifies that the Pre-Election Report should provide an update to the most recent fiscal plan, which in this case was presented in the 2018 Ontario Budget. Accordingly, the fiscal forecasts presented in the Pre-Election Report were identical to those in the 2018 Budget.

Our review highlighted that the Pre-Election Report's presentation of the Province's finances was not reasonable, as it understated Ontario's deficit and expense estimates for two items. After adjusting for these items, the annual deficit would be $11.7 billion for 2018/19 (or 75% more than the reported $6.7 billion), $12.2 billion for 2019/20 (or 85% more than the reported $6.6 billion) and $12.5 billion for 2020/21 (or 92% more than the reported $6.5 billion). The two understated expense items are:

- The government failed to properly reflect the true financial impact of its Fair Hydro Plan's electricity rate reduction in its estimates.
- The government forecast pension revenues relating to the Ontario Teachers' Pension Plan to reduce expenses, and understated future pension expenses for the Ontario Public Service Employees' Union Pension Plan, even though the government did not have the unilateral right to use funds in these pension plans without first reaching a formal agreement with the plans' other sponsors.

As noted in **Section 3.7**, the effects of these two items on expenses and the annual deficit were properly reflected in the Province's consolidated financial statements for the year ended March 31, 2018.

The Pre-Election Report was the third issued in Ontario (the first two were issued in 2007 and 2011). From the time that the Act was passed in 2004 until 2016, the fixed election date was set as the first Thursday in October, every four years.

In December 2016, the *Election Statute Law Amendment Act, 2016* was passed to move the fixed election date to the first Thursday in June, every four years, to help ensure the Ontario provincial fixed election date would not overlap with Ontario's municipal election date. This change reduced the time between the issuance of the Pre-Election Report and the fixed election date by 17 weeks. Our Office completed our review with the co-operation of staff at the Ministry of Finance and Treasury Board Secretariat, along with other ministries.

7.0 Ontario's Debt Burden

We commented in previous annual reports on Ontario's growing debt burden, attributable to its large deficits and its investments in capital assets such as infrastructure, and we do so again this year.

In reporting on the Province's debt burden, the current government restated Ontario's debt figures in the 2017/18 consolidated financial statements to be in accordance with Canadian PSAS for two issues (described in more detail in **Section 3.7**): accounting for the net pension assets of the OTPP and the OPSEUPP, and accounting for the projected costs of the Fair Hydro Plan.

As a result, Ontarians now have a truer picture of Ontario's debt. We noted that the Province has relied on historically low interest rates to keep its debt-servicing costs relatively stable, but the debt itself, whether measured as total debt, net debt or accumulated deficit, has continued to grow, as illustrated in **Figure 2**. The three measures of debt are defined below:

- *Total debt* is the total amount of borrowed money the government owes to external parties, and consists of bonds issued in public capital markets, non-public debt, T-bills and U.S. commercial paper. Total debt provides the broadest measure of a government's debt load.
- *Net debt* is the difference between the government's total liabilities and its financial assets. Liabilities consist of all amounts the government owes to external parties, including total debt, accounts payable, pension and retirement obligations, and transfer-payment obligations. Financial assets are those that theoretically can be used to pay off liabilities or finance future operations, and include cash, accounts receivable, temporary investments and investments in government business enterprises. Net debt provides a measure of the amount of future revenues required to pay for past government transactions and events.
- *Accumulated deficit* represents the sum of all past annual deficits and surpluses of the government. It can also be derived by deducting

Figure 2: Total Debt, Net Debt and Accumulated Deficit, 2012/13–2020/21

Sources of data: March 31, 2018, Province of Ontario Consolidated Financial Statements; 2018 Ontario Budget; and the Office of the Auditor General of Ontario

	Actual ($ million)						Estimate ($ million)		
	2012/13	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Total debt	281,065	295,758	314,960	327,413	333,102	348,660	358,837	369,000	384,400
Restated net debt*	259,947	276,169	294,557	306,357	314,077	323,834	346,528	369,911	393,274
Restated accumulated deficit*	174,256	184,835	196,665	203,014	205,939	209,023	220,640	232,911	245,474

* Restated for the net pension assets and the Fair Hydro Plan.

the value of the government's non-financial assets, such as its tangible capital assets, from its net debt.

7.1 Main Contributors to Net Debt

The Province's growing net debt is attributable to its large annual operating deficits, along with its capital expenditures for assets such as buildings and other infrastructure and equipment, whether acquired directly or through public-private partnerships. This extends to assets acquired for the government or its consolidated organizations, such as public hospitals, as illustrated in **Figure 3**, but not government business enterprises, such as Ontario Power Generation (OPG).

After properly accounting for the net pension assets of the OTPP and the OPSEUPP and the expected costs of the Fair Hydro Plan, the Province is projected to have annual deficits over the next three years, and net debt will continue to rise as the government borrows to finance its operations.

Ontario's net debt may increase by 80% over the 10-year period between 2011/12 and 2020/21, from $217.8 billion to approximately $393.3 billion. As illustrated in **Figure 2**, we estimate total debt will be $384.4 billion by 2020/21.

To put this in perspective, the amount of net debt owed by each resident (including children) of Ontario on behalf of the government is expected to increase from about $16,943 per person in 2011 to about $26,865 per person in 2021. In other words, it would cost every Ontarian $26,865 to eliminate the Province's net debt in 2021. In 2018, the amount of net debt owed by each resident of Ontario was $22,529.

7.2 Ontario's Ratio of Net Debt to GDP

A key indicator of the government's ability to carry its debt is the level of debt relative to the size of the economy. The ratio of net debt to the market value of goods and services produced by an economy (the

Figure 3: Net Debt Growth Factors, 2011/12–2020/21 ($ million)

Sources of data: March 31, 2018, Province of Ontario Consolidated Financial Statements; 2018 Ontario Budget; and the Office of the Auditor General of Ontario

	Restated Net Debt Beginning of Year[1]	Deficit/ (Surplus)	Net Investment in Tangible Capital Assets[2]	Miscellaneous Adjustments[3]	Restated Net Debt End of Year[1]	Increase/ (Decrease)
Actual						
2011/12	217,754	12,969	7,234	3,955	244,912	24,158
2012/13	241,912	9,220	7,784	1,031	259,947	18,035
2013/14	259,947	10,453	5,600	169	276,169	16,222
2014/15	276,169	10,315	6,509	1,564	294,557	18,388
2015/16	294,557	5,346	5,450	1,004	306,357	11,800
2016/17	306,357	2,435	4,795	490	314,077	7,720
2017/18	314,077	3,672	6,673	(588)	323,834	9,757
Estimated						
2018/19	323,834	6,700	14,200	1,749	346,528	22,694
2019/20	346,528	6,600	15,700	1,083	369,911	23,383
2020/21	369,911	6,500	15,800	1,063	393,279	23,363
Total over 10 years	**—**	**74,210**	**89,745**	**11,565**	**—**	**175,520**

1. Restated for the net pension assets and the Fair Hydro Plan.
2. Includes investments in government-owned and broader-public-sector land, buildings, machinery and equipment, and infrastructure assets capitalized during the year, less annual amortization and net gains reported on sale of government-owned and broader-public-sector tangible capital assets.
3. Unrealized Fair Value Losses/(Gains) on the Ontario Nuclear Funds Agreement (ONFA) Funds held by Ontario Power Generation Inc. and accounting changes.

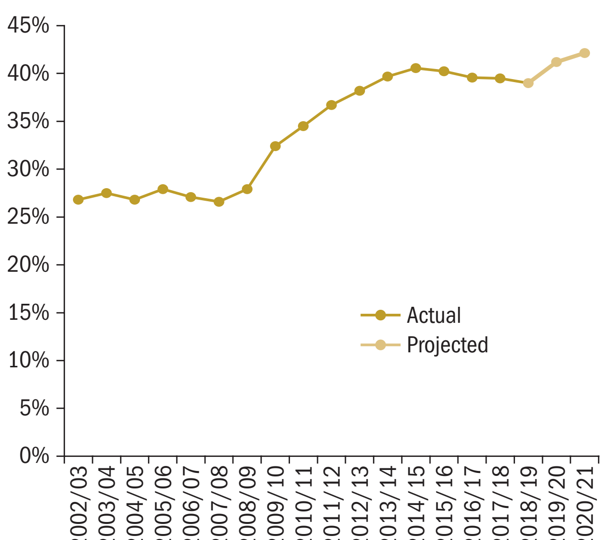
gross domestic product, or GDP) measures the relationship between a government's obligations and its capacity to raise the funds needed to meet them. It is an indicator of the burden of government debt on the economy.

If the amount of debt that must be repaid relative to the value of the GDP is rising—in other words, the ratio is rising—it means the government's net debt is rising faster than the provincial economy, and is becoming a growing burden.

Figure 4 shows that the Province's net debt-to-GDP ratio remained constant, from 26.8% in 2002/2003 to 26.6% in 2007/08. However, it has been trending upward since then, reflecting factors such as significantly increased borrowing to fund annual deficits and infrastructure spending. Ontario's net debt-to-GDP ratio rose from approximately 26.6% prior to the 2008/09 recession to approximately 39.0% in 2017/18. We project Ontario's net debt will increase by $69.4 billion over the next three years, resulting in the net debt-to-GDP ratio rising to 42.1%.

Figure 4: Ratio of Net Debt to Gross Domestic Product (GDP), 2002/03–2020/21

Source of data: March 31, 2018, Province of Ontario Annual Reports—Financial Statement Discussion and Analysis; 2018 Ontario Budget; and the Office of the Auditor General of Ontario



Note: Net debt restated for the net pension assets and the Fair Hydro Plan.

The previous government committed to reducing the net debt-to-GDP ratio to its pre-recession level of 27% by 2029/30, together with an interim net debt-to-GDP ratio of 35% by 2023/24—but excluded this commitment from its 2018 Budget.

We noted in our previous Annual Reports that many experts believe when a jurisdiction's net debt-to-GDP ratio rises above 60%, that jurisdiction's fiscal health is at risk and is vulnerable to unexpected economic shocks. Of significance, the Financial Accountability Office in its report on the *Long-Term Budget Outlook 2017*, released October 19, 2017, projected Ontario's net debt-to-GDP ratio would rise to 63% by 2050/51, significantly above today's ratio of 39.1%.

We also noted it is an oversimplification to rely on just one measure to assess a government's borrowing capacity, because that measure does not take into account Ontario's share of federal and municipal debts. If the Province's share of those debts was included in its indebtedness calculations, the net debt would be considerably higher. However, consistent with debt-measurement methodologies used by most jurisdictions, we have focused throughout our analysis only on the provincial government's direct net debt.

Figure 5 shows the net debt of Ontario compared to other provinces and the federal government, along with their respective ratios of net debt to GDP. Generally, the western provinces have a significantly lower net debt-to-GDP ratio than Ontario and the Atlantic provinces, and Quebec has a higher ratio than Ontario.

7.3 Other Measures to Assess Government Debt Levels

7.3.1 Ratio of Net Debt to Total Annual Revenues

Another useful measure of government debt is the ratio of net debt to total annual revenues, an indicator of how much time it would take to eliminate the

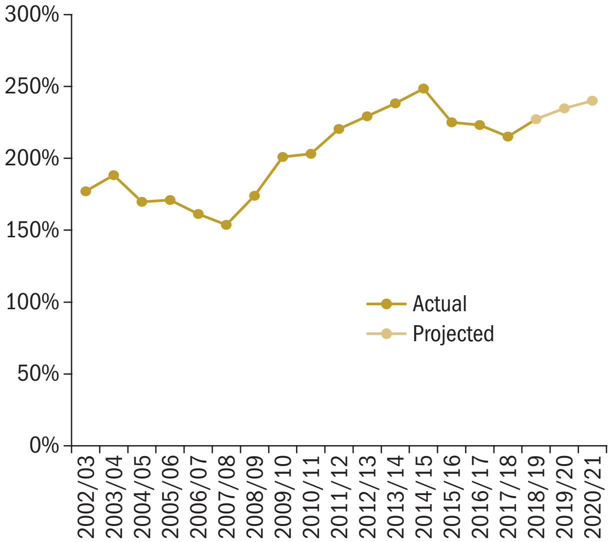
Figure 5: Net Debt and the Net-Debt-to-GDP Ratios of Canadian Jurisdictions, 2016/17

Sources of data: Province of Ontario Annual Report and Consolidated Financial Statements; Annual Reports and Consolidated Financial Statements of other provincial jurisdictions; federal budgets and budget updates; budgets of provincial jurisdictions; and the Office of the Auditor General of Ontario

	Net Debt ($ million)	Net Debt to GDP (%)
AB	19,344	6.0
SK	11,288	14.3
BC	41,869	14.9
PEI	2,208	33.1
MB	24,365	34.6
NS	14,959	34.6
Federal	758,763	35.4
ON	323,834	39.0
NB	13,926	39.2
QC	181,141	43.9
NL	14,674	45.2

Figure 6: Net Debt as Percentage of Total Annual Revenue, 2002/03–2020/21

Sources of data: March 31, 2018, Province of Ontario Consolidated Financial Statements; 2018 Ontario Budget; and the Office of the Auditor General of Ontario



Note: Net debt restated for the net pension assets and the Fair Hydro Plan.

debt if the Province spent all of its revenues only on debt repayment. For instance, a ratio of 250% indicates that it would take 2.5 years to eliminate the provincial debt if all revenues were devoted exclusively to it.

As shown in **Figure 6**, this ratio declined from about 177% in 2002/2003 to about 154% in 2007/08, reflecting the fact that the Province's net debt grew at a slower pace than annual provincial revenue. However, the ratio has increased steadily since 2007/08, and was expected to reach 240% by 2020/21. The ratio currently sits at 215%. This increasing ratio indicates the Province's net debt burden has relatively less revenue to support it.

7.3.2 Ratio of Interest Expense to Revenue

Increases in the cost of servicing total debt (interest expense), can directly affect the quantity and quality of programs and services that government can provide; the higher the proportion of government revenues going to pay interest costs on past borrowings, the lower the proportion available for spending in other areas.

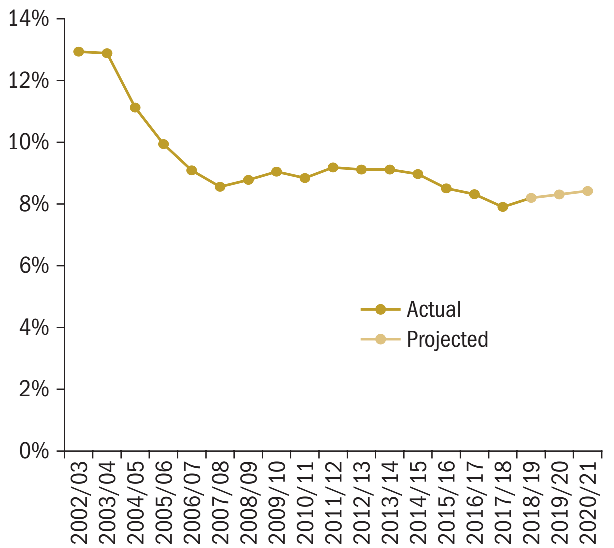
The interest-expense-to-revenue ratio illustrates the extent to which servicing past borrowings takes a greater or lesser share of total revenues.

As **Figure 7** shows, interest rates have been at historic lows since the beginning of this decade, and the actual interest-expense-to-total-revenues ratio held steady at around 9.0% from 2010/11 to 2014/15. In 2016/17, the government consolidated the broader public sector on a line-by-line basis, which increased both interest expense and revenue reported in the Province's consolidated financial statements beginning in 2015/16. By including the broader public sector, the ratio has decreased to 8.5% in 2015/16. The ratio stood at 7.9% in 2017/18 and is projected to be 8.4% in 2020/21. This means approximately 8.4 cents of every dollar in revenue that the government collects will go toward paying interest on debt by 2020/21.

The Province's debt also exposes it to further risks, the most significant being interest-rate risk. As noted above, interest rates in the past few years have been at record low levels, enabling the government to keep its annual interest expense relatively

Figure 7: Ratio of Interest Expense to Revenue, 2002/03–2020/21

Sources of data: March 31, 2018, Province of Ontario Consolidated Financial Statements; 2018 Ontario Budget; and the Office of Auditor General of Ontario



steady even as its total borrowing has increased significantly. However, interest rates began to rise in 2017/18 and there is an increasing risk that the government will have considerably less flexibility to provide public services such as health care and education, because a higher proportion of revenues will be required to pay interest on the Province's outstanding debt.

As we noted in previous Annual Reports, the Province has mitigated its interest-rate risk to some extent by increasing the weighted average term of its annual borrowings in order to take advantage of the current low rates. However, the Bank of Canada raised its key lending rate five times between April 1, 2017, and October 24, 2018. When the Province refinances debt at a higher interest rate than that paid on maturing debt, then the average interest expense on Provincial debt will rise. This means more money will go toward interest expense, therefore increasing the annual deficit.

The ratio of interest expense to revenue is expected to continue to rise in the near future as more interest will be paid on the accumulated debt, meaning the government will have less flexibility to respond to changing economic circumstances.

Past governments' borrowing and debt-servicing decisions mean a growing portion of revenues will not be available for other current and future government programs.

7.4 Consequences of High Indebtedness

Our commentary last year highlighted the consequences for the Province of carrying a large debt load—and the same observations remain relevant this year. They include the following:

Debt-servicing costs cut into funding for other programs: As debt grows, so do interest costs. As interest costs consume a greater proportion of government resources, there is less to spend on other things. To put this "crowding-out" effect into perspective, the government currently spends more on debt interest than on post-secondary education.

Greater vulnerability to interest-rate increases: Ontario has been able to keep its annual interest expense relatively steady, even as its total borrowing has increased significantly. For example, it was paying an average effective interest rate of about 8.4% in 1999/2000, but that dropped to 3.6% in 2017/18. However, if interest rates start to rise again, the government will have considerably less flexibility to provide public services because it will have to devote a higher proportion of its revenue to interest payments.

Potential credit-rating downgrades could lead to higher borrowing costs: Prepared by specialized agencies, credit ratings assess a government's creditworthiness based largely on its capacity to generate revenue to service its debt. The four main credit-rating agencies are Moody's Investors Service (Moody's), Standard and Poor's Global Ratings (S&P), DBRS and Fitch Ratings (Fitch). To assign a rating, agencies consider such factors as a government's economic resources and prospects, industrial and institutional strengths, financial health, and susceptibility to major risks.

In 2018, both Moody's and Fitch revised their rating outlook for Ontario's debt from stable to negative, reflecting their assessment of the Province's increased credit risk. While Ontario's credit rating remained unchanged, the four main agencies cited several concerns regarding Ontario's credit outlook, including the Province's high and rising debt burden, the projection of ongoing deficits, and the risk of a future economic downturn.

A credit rating affects the cost of future borrowing, with a lower rating indicating that an agency believes there is a relatively higher risk that a government will default on its debt. Accordingly, investors will lend to that government only in return for a greater risk premium, in the form of higher interest rates. A rating downgrade could also shrink the potential market for a government's debt, because some investors will not hold debt below a certain rating.

7.5 Final Thoughts on Ontario's Debt Burden

We recognize that, ultimately, decisions about how much debt the Province should carry, and the strategies to pay down that debt, are questions of government policy and thus the sole prerogative of the government.

However, as we observed last year, this should not prevent the government from providing information to promote a greater understanding of the issue and clarify the choices it makes around provincial debt. We acknowledge that the new government has only recently taken office and will need some time to determine its strategy for addressing Ontario's debt burden and to set a feasible target in a reasonable time frame.

RECOMMENDATION 2

We recommend that in order to address the Province's growing total debt burden, the government work toward the development of a long-term total-debt reduction plan, including a target for the net-debt-to-GDP ratio.

MINISTRY OF FINANCE RESPONSE

The government is taking steps to address public debt. As recommended by the Independent Financial Commission of Inquiry, the government will determine and set an appropriate target and timeline to reduce the net-debt-to-GDP ratio, as part of the development of a debt reduction strategy to improve Ontario's fiscal health.

8.0 Update on WSIB

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation created by the *Workplace Safety and Insurance Act, 1997* (Act). Its primary purpose is to provide income support and medical assistance to workers injured on the job. The WSIB receives no funding from government; it is financed through premiums on employer payrolls.

Over the past decade, we raised a number of concerns about significant growth in the WSIB's unfunded liability, which is the difference between the value of the WSIB's assets and its estimated financial obligations to pay benefits to injured workers. Our *2009 Annual Report* discussed the risk that the growth and magnitude of the unfunded liability posed to the WSIB's financial viability, including the ultimate risk of the WSIB being unable to meet its existing and future commitments to provide worker benefits.

We previously recommended that the government reconsider its decision to exclude the WSIB's financial results from the Province's consolidated financial statements, particularly if there were any risks that the Province might have to provide funding to ensure the WSIB remained viable. The government previously excluded WSIB's financial results because it is classified as a "trust"; however, given the WSIB's significant unfunded liability and various other factors, we questioned whether the WSIB operates like a true trust. Including the WSIB in the government's consolidated financial statements would have a significant impact on the government's fiscal performance.

As of June 30, 2010, the WSIB's unfunded liability had grown to almost $13 billion. In September 2010, the WSIB announced an independent funding review to obtain advice on how to best ensure the long-term financial viability of Ontario's workplace safety and insurance system. The May 2012 report contained a number of recommendations, in particular calling for a new funding strategy for the WSIB with the following key elements:

- realistic assumptions, including a discount rate based on the best actuarial advice;
- moving the WSIB as quickly as feasible beyond a "tipping point" of a 60% funding Sufficiency Ratio (a tipping point is a crisis in which the WSIB could not generate sufficient funds to pay workers' benefits within a reasonable time and by reasonable measures); and
- putting the WSIB on course to achieve a 90%–110% funding Sufficiency Ratio within 20 years.

In response to our concerns and to the recommendations of the report, the government passed Regulation 141/12 under the Act in June 2012. Effective January 1, 2013, it required the WSIB to ensure it meets the following funding Sufficiency Ratios by specified dates:

- 60% on or before December 31, 2017;
- 80% on or before December 31, 2022; and
- 100% on or before December 31, 2027.

The government also passed Ontario Regulation 338/13 in 2013. It came into force January 1, 2014, and changed the way the WSIB calculates the funding Sufficiency Ratio by changing the method used to value its assets and liabilities. Our Office concurred with this amendment.

The WSIB issues quarterly Sufficiency Reports and an annual Economic Statement to stakeholders. As of December 31, 2017, under Regulation 141/12 as amended by Regulation 338/13, the WSIB reported a Sufficiency Ratio of 95.8% (87.4% in 2016).This means the WSIB has already achieved its December 31, 2022, funding requirement.

The WSIB now incorporates its annual update of the Sufficiency Plan within the economic statement, in which it describes the measures taken to improve its funding Sufficiency Ratio. The most recent plan is available on the WSIB website.

The WSIB's operational and financial performance was strong in 2017, as illustrated in **Figure 8**, which provides a summary of the WSIB's operating results and unfunded liability compared to 2016.

The WSIB's continued strong operating performance in 2017 resulted from improved return-to-work outcomes (91% of workers returned to work with no wage loss within 12 months, which results in fewer benefits paid out over periods longer than one year) and significant growth in investment returns (10.7% in 2017, compared to 6.3% in 2016).

The WSIB announced in its 2018 Second Quarter Results Report that it eliminated the unfunded liability and has a Sufficiency Ratio over 100%.

9.0 Ontario Place Corporation 2017 Financial Statements

This year, Ontario Place Corporation did not meet the deadline set by Treasury Board Secretariat to have its 2017 financial statements included in Public Accounts 2017/18: Volume 2 alongside the financial statements of all other significant government agencies consolidated by the Province in its annual financial statements.

The delay in finalizing Ontario Place Corporation's December 31, 2017, financial statements was due to difficulty in obtaining sufficient and appropriate audit evidence to determine the appropriate treatment of an expenditure of about $3 million by the Ministry of Tourism, Culture and Sport (Ministry) to remediate contaminated land owned by Ontario Place into a public park and trail.

Figure 8: Workplace Safety and Insurance Board (WSIB) Operating Results and Unfunded Liability, 2017 and 2016
Source of data: WSIB Financial Statements

	2017 ($ million)	2016 ($ million)
Revenue		
Premiums	4,779	4,808
Net investment income	2,914	1,504
	7,693	**6,312**
Expenses		
Benefit costs	3,147	2,747
Loss of Retirement Income Fund contributions	56	56
Administration and other expenses	409	376
Legislated obligations and commitments	252	244
Remeasurement of employee defined benefit plans	273	35
	4,137	**3,458**
Total Comprehensive Income	**3,556**	**2,854**
Less: Non-controlling Interests	(309)	(172)
Total Comprehensive Income Attributable to WSIB Stakeholders	**3,247**	**2,682**
Unfunded Liability	**710**	**3,925**

Evidence that was ultimately obtained supported treating the expenditures as an inter-entity transfer from the Ministry to Ontario Place Corporation. This transfer was recorded by Ontario Place Corporation as revenue and a corresponding remediation expense of approximately $3 million in accordance with Canadian public sector accounting standards. The 2017 financial statements of Ontario Place Corporation were issued an unqualified audit opinion on September 5, 2018, by the Office of the Auditor General of Ontario.

10.0 Changes to the Auditor's Report

The International Auditing and Assurance Standards Board (IAASB) implemented significant changes to the current standards for audit reports on financial statements for periods ended on or after December 15, 2016. The changes require auditors to provide more information in their report on the organization, its financial statements, and the nature of the audit work performed. The changes have been endorsed by the Audit and Assurance Standards Board (AASB), which sets Canadian auditing standards for financial statements, and is applicable for all audits ending on or after December 15, 2018.

As shown in **Section 3** above, the current financial statement audit report is generally a short, standardized report that describes the financial statements audited, the audit work performed, and the responsibilities of both management and the auditor.

Starting with the March 31, 2019, consolidated financial statements of the Province, the auditor's report will follow a new format. The significant changes to the independent auditor's report include, but are not limited to, the following:

- The auditor's opinion will appear at the beginning of the report instead of at the end, as is currently the case.

- The report will contain an enhanced description of the auditor's responsibilities, in particular with respect to:
  - communications with those charged with oversight;
  - concluding on the appropriateness of management's use of the going-concern basis of accounting; and
  - audit group financial statements.
- The report will include a new explicit statement that the auditor is independent of the entity and has fulfilled the auditor's other relevant ethical responsibilities.
- The report will identify those charged with oversight of the financial reporting process, along with a description of their responsibilities.
- A new section will be added if the entity prepares "other information" (for example, an annual report) that:
  - contains the independent auditor's report;
  - explains the responsibilities for the other information of management and the auditor; and
  - includes the auditor's conclusion about whether the other information is materially consistent with the financial statements or the knowledge obtained in the audit.

One of the IAASB's key changes calls for the auditor's report for certain organizations, to include a new section to communicate key audit matters that in the auditor's professional judgment were of most significance to the audit of the financial statements. These could include:

- areas identified as significant risks or involving significant management or auditor judgment;
- areas in which the auditor encountered significant difficulty, for instance in obtaining sufficient and appropriate audit evidence; and
- circumstances that required a modification to the auditor's planned audit approach, including as a result of a significant deficiency in internal control.

The new standard on communicating key audit matters is currently discretionary, unless the auditor is required to communicate the key audit matters by law or regulation. Our Office is not required by law or regulation to communicate the key audit matters in our independent auditor's report. However, we currently communicate key audit matters arising from our audit of the Province's consolidated financial statements in this chapter of our *Annual Report* and to those charged with oversight during the audit process.

11.0 Use of Legislated Accounting Standards

Canadian PSAS have been widely adopted by Canadian federal, provincial, territorial and local governments as the basis for preparation of their financial statements.

Over time, standards were developed to address increasingly complex transactions and emerging financial issues. When changes to standards have a significant impact on the accounting for and measurement of transactions affecting annual deficit/surplus or net debt, governments may be reluctant to adopt them to the extent they generate potential volatility in annual reported results.

As discussed in our *2017 Annual Report*, the previous government passed legislation in 2008, 2009, 2011 and 2012 giving it the ability to make regulations for specific accounting treatments rather than the wholesale application of independently established accounting standards. Examples include:

- In 2011, a regulation under the *Financial Administration Act* directed Hydro One, at the time wholly owned by the Ontario government, to prepare its financial statements in accordance with U.S. generally accepted accounting principles (GAAP), effective January 1, 2012. Subsequently, changes were made to the *Financial Administration Act* such that this regulation no longer applied to Hydro One following its initial public offering on the Toronto Stock Exchange in 2015. The government also required another wholly owned government business enterprise, Ontario Power Generation (OPG), to prepare its financial statements in accordance with U.S. GAAP. When the government chose to use U.S. GAAP to record the results of Hydro One and OPG in the Province's consolidated financial statements rather than International Financial Reporting Standards (IFRS), we examined the differences between IFRS and U.S. GAAP, and concluded these differences had no material effect on the Province's annual deficit. The government adopted IFRS for the purposes of recording the results of OPG and Hydro One in the Province's March 31, 2017, consolidated financial statements as required by Canadian PSAS.

- Ontario government regulations require transfers for capital acquisitions and transfers of tangible capital assets to be accounted by recipients as "deferred contributions." The deferred amounts are to be brought into revenue by transfer recipients at the same rate as they recognize amortization expense on the related assets. This prescribed accounting treatment is in accordance with PSAS.
- The 2012 Budget further amended the *Financial Administration Act* to provide the government with full authority to make regulations regarding the accounting policies and practices used to prepare its consolidated financial statements. This legislated provision was used in connection with the preparation of the 2015/16 consolidated financial statements. A time-limited regulation was passed requiring a full valuation allowance to be recorded for jointly sponsored pension plans, which was in accordance with Canadian PSAS, while in effect.
- Most recently, as noted in our Special Report titled *The Fair Hydro Plan: Concerns about Fiscal Transparency, Accountability and Value for Money*, we expressed concerns about the government legislating a complex accounting/financing structure to improperly avoid showing an annual deficit and increases in net debt. The "legislated accounting" refers to the government creating a regulatory asset through legislation. This "asset" represents the difference between what electricity generators are owed and the lesser amount being collected from electricity ratepayers as a result of the electricity rate reduction. Without the legislated accounting, the difference would be recorded as an expense rather than as an asset in the Province's consolidated financial statements. As described in **Section 3** above, the government has adjusted the transactions to comply with PSAS.

We have raised the issue of the risk of the government's potential use of legislated accounting treatment on a number of occasions in our previous Annual Reports. It is critical that Ontario continue to prepare its financial statements in accordance with generally accepted accounting standards, specifically those of Canadian PSAS, in order to maintain its financial reporting credibility, accountability and transparency.

If the government reports a deficit or surplus under legislated accounting standards that is materially different than what it would be using Canadian PSAS, the Auditor General is compelled to include a qualification in her audit opinion.

RECOMMENDATION 3

We recommend the government revisit legislation and regulations that prescribe accounting methods to be followed by the Province, and reconsider the need for these provisions in light of the fact that the Province follows the accounting standards established by the Public Sector Accounting Board.

TREASURY BOARD SECRETARIAT RESPONSE

The Province is committed to prepare its financial statements in accordance with generally accepted accounting principles in order to provide high-quality financial reports that support transparency and accountability in reporting to the public, the Legislature and other users.

12.0 Ongoing Accounting-Standards Matters

Canadian PSAS continue to be the most appropriate standards for the Province to use in preparing its consolidated financial statements. Following PSAS ensures that information provided by the government about the annual deficit or surplus is fair, consistent and comparable to previous years, allowing legislators and the public to assess the government's management of the public purse. Ontario's provincial budget is also prepared on the same basis as its consolidated financial statements.

However, the Public Sector Accounting Board (PSAB) faces challenges in reaching a consensus among its various stakeholders, including financial-statement preparers and auditors, on what accounting standards are most appropriate for the public sector.

We discuss two significant accounting issues (use of Financial Instruments in the public sector and use of Rate-Regulated Accounting in government business enterprises) that have posed a significant challenge to PSAB over the past few years. Their final accounting-standard determination will affect the way the Province accounts for these items and would have a significant impact on the Province's reported financial results.

12.1 Financial Instruments

Financial instruments include provincial debt, and derivatives such as currency swaps and foreign-exchange forward contracts. PSAB's project to develop a new standard for reporting financial instruments began in 2005, with a key issue being whether changes in the fair value of derivative contracts held by governments should be reflected in their financial statements and, in particular, whether such changes should affect a government's annual deficit or surplus.

In March 2011, PSAB approved a new public-sector accounting standard on financial instruments that was slated to become effective for fiscal periods beginning on or after April 1, 2015. The new standard provides guidance on the treatment of government financial instruments, and is similar to comparable private-sector standards.

One of its main requirements is for certain financial instruments, including derivatives, to be recorded at fair value, with any unrealized gains or losses on these instruments recorded annually in a new financial statement of remeasurement gains and losses.

Some financial-statement preparers in Canadian jurisdictions, including Ontario, do not support the introduction of these fair-value remeasurements and the recognition of unrealized gains and losses. Ontario's view is that it uses derivatives solely to manage foreign currency and interest-rate risks related to its long-term-debt holdings, and that it has both the intention and ability to hold these derivatives until the debts associated with them mature.

Accordingly, remeasurement gains and losses on the derivatives and their underlying debt would offset each other over the total period that such derivatives are held, and therefore would have no real economic impact on the government.

Ontario preparers argue that recording paper gains and losses each year would force the Province to inappropriately report the very volatility that the derivatives were acquired to avoid. This, in their view, would not reflect the economic substance of government financing transactions and would not provide the public with transparent information on government finances.

In response to such concerns, PSAB committed to reviewing the new financial instruments standard by December 2013. PSAB completed its review of *Section PS 2601, Foreign Currency Translation*, and *Section PS 3450, Financial Instruments*, and in February 2014 confirmed the soundness of the principles underlying the new standard.

PSAB deferred the effective date for these new standards to fiscal years beginning on or after April 1, 2016. In 2015, however, PSAB extended the effective date for the new standard to April 1, 2019, for senior governments to allow further study of reporting options for these complex financial instruments. In 2018, PSAB further extended the effective date for the new standard to April 1, 2021, and will be issuing an exposure draft to improve the transitional provisions and potentially address other non-hedge accounting issues raised during the consultation process.

Since February 2016, staff with PSAB have been consulting with the government and not-for-profit stakeholders on implementation issues of the financial instruments standard. The senior government community has communicated the need for a hedge accounting standard during these consultations. PSAB noted that its staff, in collaboration with stakeholders, has identified certain timing issues in the new financial-instruments standard that may impact a government's annual surplus or deficit in a manner that is unrepresentative of the underlying transactions. In its *Foreign Currency Translation — Basis for Conclusions* (Section PS 2601), PSAB stated that given "responses to due process documents issued during the financial instruments project, and the lack of consensus internationally on a hedge accounting model, PSAB has decided to adopt an approach that does not include hedge accounting." PSAB reconfirmed its decision to exclude a formal hedge accounting standard from the PS 3450 suite of standards at the Board meeting in March 2018.

We continue to recommend ongoing dialogue between our Office and the Office of the Provincial Controller Division as the PSAB reassesses the standard in preparation for implementing it on April 1, 2021.

12.2 Use of Rate-Regulated Accounting in Government Business Enterprises

Rate-regulated accounting was developed to recognize the unique nature of entities such as electric utilities whose rates are regulated by an independent regulator under most regulatory frameworks. Rate-regulated accounting is a commonly accepted practice in the U.S., especially among privately owned, government-regulated utilities. Subject to many prescriptive rules, rate-regulated accounting is used by these privately owned utilities to spread out large capital expenditures—for example, construction of a new power plant—over a longer term based on the reasonable expectation that future government-approved rate increases will allow for the eventual recovery of today's capital outlays. The government regulator often allows the privately owned entity to recover certain current-year costs from the ratepayer in future years, and these deferred costs are typically set up under rate-regulated accounting as assets on the entity's statement of financial position. Under normal accounting principles, these costs would be expensed in the year incurred.

Rate-regulated accounting is used by two of the Province's government-controlled business enterprises, Ontario Power Generation Inc. (OPG) and Hydro One, whose rates to customers are approved by the Ontario Energy Board, a government regulator. Rate-regulated accounting treatment is currently allowable for government business enterprises under Canadian generally accepted accounting principles, and in turn under Canadian public sector accounting standards.

As noted above, rate-regulated accounting provisions outline the need for an independent regulatory body to set rates. We note that, since the government controls both the regulator and the regulated entities, it has significant influence on which costs Hydro One and OPG will recognize in a given year. This could ultimately affect both electricity rates and the annual deficit or surplus reported by the government.

In our previous annual reports, we outlined that the era of rate-regulated accounting appeared to be ending for jurisdictions like Canada because they were converting to International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB), in 2012. Our comments were based on the fact that, in January 2012, Canada's Accounting Standards Board (AcSB) reaffirmed that all government business enterprises should prepare their financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2012. At that time, IFRS standards did not include accounting provisions that addressed rate-regulated activities and so, by default, IFRS standards did not permit rate-regulated accounting.

However, the rate-regulated accounting landscape has continued to evolve since then. Efforts to harmonize U.S. generally accepted accounting policies (U.S. GAAP) and IFRS were in place as Canada converted to IFRS in 2012. At that time, U.S. GAAP allowed for, and continues to allow for, rate-regulated accounting. The appropriateness of rate-regulated accounting has been discussed as part of the efforts to harmonize U.S. GAAP and IFRS. As these discussions were taking place, Canada's AcSB granted a one-year extension in March 2012 to the mandatory IFRS changeover date for entities with qualifying rate-regulated activities. Multiple one-year extensions to defer adoption of IFRS by these entities followed over the next few years.

An interim IFRS standard was issued in January 2014 as an attempt to ease the adoption of IFRS for rate-regulated entities by allowing them to continue to apply existing policies for their deferred rate-regulated balances upon adoption of IFRS starting on January 1, 2015. Essentially, the interim standard provides a first-time adopter of IFRS with relief from having to derecognize its rate-regulated assets and liabilities until the IASB completes its comprehensive review on accounting for such assets and liabilities. The result of this review and the determination of whether rate-regulated accounting will be allowed on an ongoing basis in government business enterprises, as opposed to an interim basis, is uncertain at this time.

The use of rate-regulated accounting in government business enterprises, such as Ontario Power Generation (OPG) and Hydro One, has a significant impact on the government's financial statements. For example, OPG recognized $7.2 billion in net rate-regulated assets as of March 31, 2018. Future reporting under IFRS that does not accommodate rate-regulated accounting in a government business enterprise would increase the volatility of Hydro One and OPG's annual operating results. This in turn would lead to volatility in the Province's annual deficit or surplus and may impact the government's revenue and spending decisions.

We will continue to monitor the development of standards impacting the use of rate-regulated accounting in government business enterprises.

13.0 Public Sector Accounting Board Initiatives

This section outlines some additional items that PSAB has been studying over the past year that might affect the preparation of the Province's consolidated financial statements in the future.

13.1 Concepts Underlying Financial Performance

PSAB's existing conceptual framework is a set of interrelated objectives and fundamental principles that support the development of consistent accounting standards. Its purpose is to instill discipline into the standard-setting process to ensure that accounting standards are developed in an objective, credible and consistent manner that serves the public interest.

In 2011, PSAB formed the Conceptual Framework Task Force in response to concerns raised by several governments regarding current and proposed standards that they contend cause volatility in reported results and distort budget-to-actual comparisons. The task force's objective was to review the appropriateness of the concepts and principles in the existing conceptual framework for the public sector.

The task force's first step was to seek input from stakeholders on the building blocks of the conceptual framework; these form the basis for evaluating the existing concepts underlying the measurement of financial performance. To this end, the task force issued three consultation papers: *Characteristics of Public Sector Entities* (2011), *Measuring Financial Performance in Public Sector Financial Statements* (2012) and *Conceptual Framework Fundamentals and the Reporting Model* (2015).

In May 2018, the task force issued a statement of concepts and a statement of principles. The statement of concepts proposes a revised conceptual framework that would replace two existing sections: *PS 1000, Financial Statement Concepts* and *PS 1100, Financial Statement Objectives*.

PSAB asked stakeholders to submit comments on the statement of concepts and statement of principles by November 28, 2018. The task force will take into account input received and has plans to issue exposure drafts for a revised conceptual framework and a revised financial statement presentation standard.

13.2 Review of International Strategy

In its most recent strategic plan, PSAB signalled its intent to review its approach to International Public Sector Accounting Standards (IPSAS) set out by the International Public Sector Accounting Standards Board (IPSASB). In March 2018, PSAB issued a consultation paper to solicit input from stakeholders on the criteria that PSAB should apply in developing its international strategy. PSAB presented a continuum of four international strategy alternatives. At one end, PSAB maintains its current role in setting Canadian standards; at the other end, full adoption of IPSAS, with IPSASB responsible for developing and issuing standards. PSAB also proposed two intermediate approaches that would see some form of adaptation of IPSAS.

PSAB accepted feedback on these proposals until September 28, 2018. Based on the feedback received, PSAB intends to issue a second consultation paper in 2019.

13.3 Asset Retirement Obligations

In March 2018, PSAB approved a new standard that addresses the reporting of legal obligations associated with the permanent removal of tangible capital assets from service (for example, retirement). The scope includes tangible capital assets currently in productive use, such as the decommissioning of a nuclear reactor, and tangible capital assets no longer in productive use, such as solid-waste landfill sites.

The new standard is effective for fiscal periods beginning on or after April 1, 2021, although earlier adoption is permitted. The new section requires that a retirement obligation be recognized when:

- There is a legal obligation to permanently remove retirement costs in relation to a tangible capital asset from service. Legal obligations can arise from legislation, contracts and promissory estoppel.
- The past transaction giving rise to the liability, such as acquisition, construction, development or normal use, has already occurred.
- There is an expectation that future economic benefits will be given up.
- A reasonable estimate can be made. The estimate of the liability includes costs directly

attributable to the retirement activities, including post-retirement operation, maintenance and monitoring. A present-value technique is often the best method with which to estimate the liability.

Upon recognition, the entity would increase the carrying amount of the related tangible capital asset by the same amount as the liability. The cost included in the carrying amount of the tangible capital asset should be allocated to expense in a rational and systematic manner. This could include amortization over the remaining useful life of the related tangible capital asset, or a component thereof.

The carrying amount of the liability for a retirement obligation must be reviewed at each financial reporting date. Any subsequent remeasurement of the liability due to timing, amount or discount rate is recognized as an expense.

If the related asset is no longer in productive use, or if the related asset is not recognized for accounting purposes, the related retirement costs would be recorded as an expense.

13.4 Revenue

In June 2018, PSAB approved a new standard on the recognition, measurement and presentation of revenues. The new standard *PS 3400, Revenue*, addresses revenues that arise in the public sector but fall outside the scope of *PS 3410, Government Transfers* and *PS 3510, Tax Revenues*. The section is effective for fiscal periods beginning on or after April 1, 2022, although earlier adoption is permitted.

The new standard distinguishes between two main areas of revenue: exchange transactions and unilateral (non-exchange) transactions. The existence of a performance obligation distinguishes exchange and unilateral transactions. Performance obligations are enforceable promises to provide a good or service to a payor. Exchange transactions are characterized by one or more performance obligations. By contrast, unilateral transactions, such as fines and penalties, are not associated with a performance obligation.

Revenue from an exchange transaction is recognized as or when the public-sector entity satisfies the performance obligation. Performance obligations may be satisfied at a point in time or over a period of time, depending on which method best depicts the transfer or goods or services to the payor.

Unilateral revenues are recognized when there is the authority and a past event that gives rise to a claim of economic resources.

13.5 Employment Benefits

In December 2014, PSAB approved an Employment Benefits project to improve the existing PSAS sections by taking into account changes in the related accounting concepts and new types of pension plans that were developed since the existing sections were issued decades ago. The project aims to review the existing sections, *PS 3250 Retirement Benefits* and *PS 3255 Postemployment Benefits, Compensated Absences and Termination Benefits*.

In December 2016, PSAB issued an invitation to comment on the deferral of actuarial gains and losses. Governments and other public-sector entities need to make significant assumptions when valuing pension plan obligations and plan assets. Actuarial gains and losses measure the differences between these assumptions and the plans' experience, plus any updates to the assumptions. In the past, it was common accounting practice in Canada to defer such gains and losses over an extended period. However, over the past decade, other accounting frameworks in Canada have moved toward an immediate-recognition approach. The invitation to comment sought input from stakeholders as to whether deferral is still an appropriate choice in the public sector.

In November 2017, PSAB issued an invitation to comment on discount rates. The discount rate is a key economic assumption in measuring employment benefits. A small change in the discount rate can significantly impact the value of the benefit obligation and related expenses. The current guidance is not prescriptive and can result in a wide range of practices. The invitation to comment explored alternative approaches to determining the discount rate, including the market yield of high-quality debt instruments, an approach used by many other standard-setters. Other alternatives discussed include the entity's cost of borrowing, the expected return on plan assets and the effective settlement rate at the reporting date.

PSAB accepted feedback from stakeholders until March 9, 2018. PSAB plans to publish a third invitation to comment that will focus on non-traditional pension plans such as shared-risk plans.

14.0 Statutory Matters

Under section 12 of the *Auditor General Act*, the Auditor General is 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 the Auditor General report on any transfers of money between items within the same vote in the Estimates of the Office of the Assembly.

14.1 Legislative Approval of Expenditures

Shortly after presenting its budget, the government tabled detailed Expenditure Estimates in the Legislative Assembly outlining, on a program-by-program basis, each ministry's planned spending. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and presents a report on this review to the Legislature. Orders for Concurrence for each of the estimates selected by the Committee, following a report by the Committee, are debated in the Legislature for a maximum of two hours before being voted on. The estimates of those ministries that are not selected are deemed to be passed by the Committee, reported to the Legislature, and approved by the Legislature.

After the Orders for Concurrence are approved, the Legislature still needs to provide its final approval for legal spending authority by approving a Supply Act, which stipulates the amounts that can be spent by ministries and legislative offices, as detailed in the estimates. Once the Supply Act is approved, the expenditures it authorizes are considered to be Voted Appropriations. The *Supply Act, 2018*, which pertained to the fiscal year ended March 31, 2018, received Royal Assent on March 7, 2018.

The *Supply Act* does not receive Royal Assent until after the start of the fiscal year—and sometimes even after the related fiscal year is over—so the government usually requires interim spending authority prior to its passage. For the 2017/18 fiscal year, the Legislature passed two acts allowing interim appropriations—the *Interim Appropriation for 2017–2018 Act, 2016* (Interim Act) and the *Supplementary Interim Appropriation for 2017–2018 Act, 2017* (Supplementary Act). These two acts received Royal Assent on December 8, 2016, and December 14, 2017, respectively, and authorized the government to incur up to $133.6 billion in public-service expenditures, $4.6 billion in investments, and $219.5 million in legislative office expenditures. Both acts were made effective as of April 1, 2017, and provided the government with sufficient authority to allow it to incur expenditures from April 1, 2017, to when the *Supply Act, 2018* received Royal Assent on March 7, 2018.

Because the legal spending authority under the Interim Act and the Supplementary Act was intended to be temporary, both were repealed when the *Supply Act, 2018* received Royal Assent. The *Supply Act, 2018* also increased total authorized expenditures in investments from $4.6 billion to $5.3 billion, and increased total authorized expenditures of the legislative offices from $219.5 million to $251.8 million.

14.2 Special Warrants

If the Legislature is not in session, 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 and approved by the Lieutenant Governor on the recommendation of the government.

No Special Warrants were issued for the fiscal year ended March 31, 2018.

14.3 Treasury Board Orders

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 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 government closes the books for the fiscal year. 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 published and tabled in the Legislature.

Even though the *Treasury Board Act, 1991* was repealed and re-enacted within the *Financial Administration Act* in December 2009, subsection 5(4) of the repealed act was retained. This provision allows the Treasury Board to delegate any of its duties or functions to any member of the Executive Council or to any public servant employed under the *Public Service of Ontario Act, 2006*. Such delegations continue to be in effect until replaced by a new delegation. Since 2006, the Treasury Board has delegated its authority for issuing Treasury Board Orders to ministers to make transfers between programs within their ministries, and to the Chair of the Treasury Board for making program transfers between ministries and making supplementary appropriations from contingency funds. Supplementary appropriations are Treasury Board Orders in which the amount of an appropriation is offset by a reduction to the amount available under the government's centrally controlled contingency fund.

Figure 9 summarizes the total value of Treasury Board Orders issued for the past five fiscal years, and **Figure 10** summarizes Treasury Board Orders for the fiscal year ended March 31, 2018, by month of issue.

Figure 9: Total Value of Treasury Board Orders, 2013/14–2017/18 ($ million)

Source of data: Treasury Board

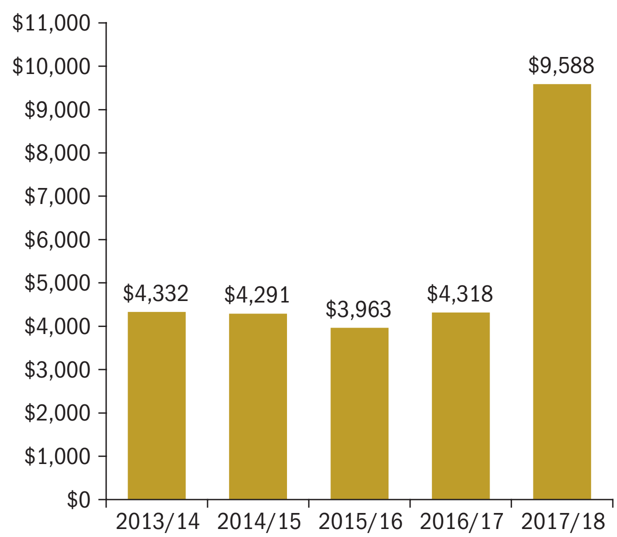


Figure 10: Total Value of Treasury Board Orders by Month Relating to the 2017/18 Fiscal Year

Source of data: Treasury Board

Month of Issue	#	Authorized ($ million)
April 2017–February 2018	118	1,921
March 2018	33	1,007
April 2018	8	131
May 2018–June 2018	0	–
July 2018–August 2018	5	1,251
September 2018	4	5,278
Total	**168**	**9,588**

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 2017/18 fiscal year are expected to be published in *The Ontario Gazette* in December 2018. A detailed listing of 2017/18 Treasury Board Orders, showing the amounts authorized and expended, is included in **Exhibit 4** of this report.

14.4 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, **Figure 11** shows the transfers made within Vote 201 with respect to the 2017/18 Estimates.

14.5 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 the subject of a settlement or deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2017/18 fiscal year, receivables of $353 million ($267 million in 2016/17) due to the Crown from individuals and non-government organizations were written off. The write-offs in the 2017/18 fiscal year related to the following:

Figure 11: Authorized Transfers Relating to the Office of the Assembly, 2017/18 Fiscal Year

Source of data: Board of Internal Economy

From:		$
Item 3	Legislative Services	(227,900)
Item 4	Information and Technology Services	(274,800)
To:		
Item 5	Administrative Services	189,900
Item 6	Sergeant at Arms and Precinct Properties	284,800
Item 11	Ontario Legislative Internship Program	28,000

- $150 million for extinguishing a loan to U.S. Steel Canada (Stelco) to comply with a court decision;
- $45.8 million for uncollectible receivables under the Student Support Program ($49.9 million in 2016/17);
- $42.3 million for uncollectible corporate tax ($64.4 million in 2016/17);
- $34.4 million for uncollectible receivables under the Ontario Disability Support Program ($45.9 million in 2016/17);
- $25.4 million for uncollectible retail sales tax ($40.3 million in 2016/17);
- $17.1 million for uncollectible employer health tax ($27.3 million in 2016/17); and
- $38.0 million for other tax and non-tax receivables ($39.2 million in 2016/17).

Volume 2 of the 2017/18 Public Accounts summarizes the write-offs by ministry. Under the accounting policies followed in the preparation of the Province's consolidated financial statements, a provision for doubtful accounts is recorded against accounts receivable balances. Most of the write-offs had already been expensed in the Province's consolidated financial statements. However, the actual write-off in the accounts required Order-in-Council approval.