

Legislative
Assembly
of Ontario



Assemblée
législative
de l'Ontario

STANDING COMMITTEE ON PUBLIC ACCOUNTS

PUBLIC ACCOUNTS OF THE PROVINCE

(CHAPTER 2, 2018 ANNUAL REPORT OF THE OFFICE OF THE AUDITOR
GENERAL OF ONTARIO)

1st Session, 42nd Parliament
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The Honourable Ted Arnott, MPP
Speaker of the Legislative Assembly

Sir,

Your Standing Committee on Public Accounts has the honour to present its Report and commends it to the House.

A handwritten signature in blue ink that reads "Catherine Fife".

Catherine Fife, MPP
Chair of the Committee

Queen's Park
February 2020

STANDING COMMITTEE ON PUBLIC ACCOUNTS
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1st Session, 42nd Parliament

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*MICHAEL GRAVELLE was replaced by JOHN FRASER on October 31, 2019.

JILL DUNLOP and SANDY SHAW regularly served as substitute members of the
Committee.

CHRISTOPHER TYRELL
Clerk of the Committee

LAURA ANTHONY
Research Officer

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INTRODUCTION

On April 3, 2019, the Standing Committee on Public Accounts held public hearings on the audit (Chapter 2, 2018 *Annual Report* of the Auditor General of Ontario) of the Public Accounts of the Province administered by the Ministry of Finance and the Treasury Board Secretariat.

The Committee endorses the Auditor's findings and recommendations, and presents its own findings, views, and recommendations in this report. The Committee requests that the Ministry provide the Clerk of the Committee with written responses to the recommendations within 120 calendar days of the tabling of this report with the Speaker of the Legislative Assembly, unless otherwise specified.

ACKNOWLEDGEMENTS

The Committee extends its appreciation to officials from the Treasury Board Secretariat, Ministry of Finance, Ministry of Energy, Ontario Financing Authority and the Independent Electricity System Operator. The Committee also acknowledges the assistance provided during the hearings and report-writing deliberations by the Office of the Auditor General, the Clerk of the Committee, and staff in the Legislative Research Service.

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 Secretariat (TBS). The Public Accounts consist of the Province's annual report, including the consolidated financial statements, and three supplementary volumes of additional financial information.

The Treasury Board Secretariat is responsible for preparing the consolidated financial statements and ensuring that this information, including many amounts based on estimates and judgment, is presented fairly. The Treasury Board Secretariat is also responsible for ensuring that an effective system of control, with supporting procedures, is in place to authorize transactions, safeguard assets, and maintain proper records. The Government is responsible for ensuring that this is all in place, and for ensuring the preparation of accurate and reasonable consolidated financial statements.

AUDIT OBJECTIVES AND SCOPE

The Office of the Auditor General (Office) audits the consolidated financial statements, with the objective of expressing an opinion on whether the consolidated financial statements are fairly presented, and free of significant errors or omissions and are prepared in accordance with Canadian Public Sector Accounting Standards (PSAS). The consolidated financial statements, along with

the Independent Auditor's Report, are included in the Province's annual report, along with the Financial Statement Discussion and Analyses.

In 2018, the Auditor General issued an unqualified or "clean" audit opinion on the Province's consolidated financial statements for 2017/18, after having issued a qualified opinion for the previous two years. The Auditor's Office stated it is critical that Ontario continue to prepare its financial statements in accordance with Canadian Public Sector Accounting Standards.

MAIN POINTS OF AUDIT

The Auditor General stated the unqualified opinion was issued as a result of changes to the Province's financial statements to comply with Canadian PSAS. The Province

- 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;
- 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; and
- reversed the use of rate-regulated accounting in connection with certain balances.

Similar to previous years, the report highlighted that the interests of the 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. The Independent Financial Commission of Inquiry also noted similar comments in its report.

The Auditor's Office conducted a special financial statement audit of the IESO in early 2018. The Office indicated it faced atypical pushback on audit inquiries from the IESO Board, such as refusals to provide the Office with written acknowledgement of the IESO's roles and responsibilities or a management representation letter confirming that the IESO shared all of the information that may affect its financial statements. These are standard letters required for each audit under the Canadian Auditing Standards. Consequently, the Auditor General issued a disclaimer of opinion as required by the Canadian Auditing Standards.

The Auditor's Office expressed continued concern about the Province's growing debt burden without a debt plan in place, and estimated that Ontario's total debt may increase to \$384.4 billion in 2020/21. Further, the Auditor's Office estimated Ontario's net debt will increase by \$69.4 billion over the next three years, increasing the net debt-to-GDP ratio to 42.1% (from approximately 39.0% in 2017/18). Growth in debt is attributable to on-going large operating deficits (indicative of a structural deficit) and capital expenditures for assets, such as buildings and other infrastructure and equipment.

The Auditor's Office again raised concerns about the risk of the government's potential use of legislated accounting treatments (similar to previous *Annual*

Reports). The Auditor General noted that in this context, the term “legislated accounting treatments” refers to situations where a government passes Acts or Regulations for the use of accounting which is contrary to Canadian Public Sector Accounting Standards (PSAS). The audit stated it is important that Ontario continue to prepare its financial statements in accordance with generally accepted accounting standards, in this case PSAS, in order to maintain financial reporting credibility, accountability and transparency.

ISSUES RAISED IN THE AUDIT AND BEFORE THE COMMITTEE

A number of issues were raised in the report and before the Committee. The Committee considers the issues below to be of particular importance.

The Treasury Board Secretariat stated the Province’s consolidated financial statements are prepared in accordance with Canadian PSAS. Treasury Board representatives explained that the 2017/18 public accounts reflect the Auditor General’s *2017 Annual Report* recommendations regarding the net pension assets valuation and accounting treatment of the Fair Hydro Plan.

The Treasury Board told the Committee that many of the Independent Financial Commission of Inquiry’s recommendations were relevant to the preparation of the 2017/18 public accounts. In particular, representatives highlighted two of the Commission’s recommendations. The first was that the Province adopt the Auditor General’s proposed accounting treatment for any net pension assets of the Ontario Teachers’ Pension Plan (OTPP) and Ontario Public Service Employees’ Union Pension Plan (OPSEUPP). The second was that the Province adopt the Auditor General’s proposed accounting treatment for the global adjustment refinancing (a major component of the Fair Hydro Plan). The Committee heard while the Commission provided guidance on the valuation of the net pension assets, it did not provide direction on the inclusion of the IESO market accounts. The Auditor’s prior reports indicated that the inclusion of the IESO market accounts on the Province’s consolidated financial statements only arose in relation to the accounting for the Fair Hydro Plan and was contrary to PSAS. Treasury Board explained that the Province subsequently decided to remove the IESO market accounts from the public accounts. Treasury Board stated these changes were instrumental for the Auditor’s unqualified audit opinion on the 2017/18 public accounts.

USE OF EXTERNAL CONSULTANTS

Similar to recommendations in Chapter 2 of the Auditor’s 2016 and 2017 *Annual Reports*, the 2018 report stated that the interests of the 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 accounting advisors. The audit found there was an inherent conflict of interest in 2017/18 when the IESO Board engaged the same private accounting firm, KPMG, both to perform the audit of the IESO’s financial statements and to provide accounting advice directly to the government as well as the IESO relating to the design and implementation of the former government’s Fair Hydro Plan.

The Committee asked how Treasury Board Secretariat and the IESO will keep the Auditor General abreast of the work of private sector external auditors. The TBS told the Committee it met with the Auditor General prior to the preparation of the 2017/18 public accounts in order to improve communication and the exchange of information. Further, the TBS said it has implemented instructions across the government to collect information related to the contracting of external accounting advisors. Representatives said this will support proactive notification and consultation with the Auditor's Office when ministries, consolidated agencies, and crown-controlled corporations propose to engage an external advisor for accounting advice.

The Committee also asked the TBS how it plans to manage conflicts arising from the use of the same audit firm for both auditing component financial statements and providing accounting advisory work. It was explained that any potential conflict would be identified by the ongoing reporting that is required, and it would be acknowledged or addressed by the ministry.

The Committee asked the IESO what steps it has taken to ensure better cooperation with the Auditor's Office. The IESO stated it is committed to open communication with the Auditor's Office and understands the requirement to consult with the Auditor. The IESO told the Committee it appointed the Auditor General as its financial statement auditor for the fiscal year ending 2018, and obtained an unqualified audit opinion. The Committee also asked what specifically has changed with the IESO's governance. The IESO explained that a lot in the external environment has changed, and cited the decision of the government to fund the Fair Hydro Plan from the tax base (as opposed to the rate base).

The Auditor General indicated to the Committee that because Fair Hydro decisions were made directly by the former government and that no independent regulator ruled on the impact to rates, the transaction itself would properly, under PSAS, have a tax base impact. The decision of the current government was to properly reflect this fact in its accounting treatment of the on-going, annual financial impact from the Fair Hydro Plan.

The Committee also heard that the IESO, as recommended by the Auditor General, adjusted its accounting policies to no longer use rate-regulated accounting. The IESO also made changes to how its financial statements are presented and to correct the discount rate used to value the IESO's non-registered pension and other post-employment benefit plans.

Committee Recommendations

The Standing Committee on Public Accounts recommends that:

- 1. The *Auditor General Act* should be amended to**
 - a. require government ministries, and agencies and crown corporations which are consolidated into the Province's financial statements to give advance notice to the Auditor General and ask for comment regarding external auditing firms they propose to hire to perform an audit or provide accounting advice; and**

- b. allow the Office of the Auditor General of Ontario to reject the proposed selection of external auditing firms hired to perform financial statement audits on agencies and crown corporations which are consolidated into the Province's financial statements, and those that provide accounting advice to government ministries or agencies and crown corporations.**
- 2. The *Auditor General Act* should be amended to give the Office of the Auditor General of Ontario the authority and discretion to be the appointed financial statement auditor of agencies, organizations, and crown corporations consolidated into the Province's financial statements.**
- 3. Treasury Board Secretariat should communicate to ministries, agencies, and crown corporations that any external auditing firm that audits the financial statements of a ministry, agency or crown corporation which consolidate into the Province's financial statements, and which is deemed material by the Office of the Auditor General of Ontario, shall not provide accounting advice or accounting advisory services for the ministry that the agency or crown corporation reports to, or to Treasury Board Secretariat, or to other ministries, agencies or crown corporations that may be involved in a related party transaction.**

DEBT BURDEN

The report said that Ontario's restated net debt was \$323 million in 2017/18 (after accounting for net pension assets of the OTPP, OPSEUPP, and projected costs of the Fair Hydro Plan). As noted earlier, the Auditor's Office estimated Ontario's net debt will increase by \$69.4 billion over the next three years, increasing the net debt-to-GDP ratio to 42.1% (from approximately 39.0% in 2017/18). The report expressed concern about the consequences of high indebtedness without a debt plan in place considering debt-servicing costs cutting into funding for other programs, greater vulnerability to interest-rate increases, and potential credit-rating downgrades, which could lead to higher borrowing costs.

The Committee asked about the Province's plans to address the debt burden and the potential consequences of not addressing the debt. The Ministry of Finance stated the government provides a great deal of disclosure about its debt reduction strategy through the financial statements. In terms of managing the debt burden, representatives explained this is demonstrated by how the government prioritizes its investments, makes trade-offs, or delays other investments. The Ministry of Finance told the Committee that the current government has committed to developing a debt burden reduction strategy. It was explained to the Committee that all the debt must be repaid, and the consequences of not paying back are severe in terms of future access to capital markets as well as the cost of servicing the debt.

The Committee asked various questions about the Province's relationship with credit rating agencies. The Ministry of Finance explained that it works with credit rating agencies, which consider a broad range of factors when determining a

credit score, including economic fundamentals, institutional framework, and financial performance. The Committee heard that the process that informs a credit rating is ongoing and continuous.

The Committee asked about the Province's debt obligation for the Fair Hydro Trust. The IESO explained that it continues to work with a monthly shortfall (due to the government policy decision to reduce hydro bills by 25%) between what it owes to energy providers versus what it recoups in ratepayers bills. Under the Fair Hydro Plan, this shortfall was paid by the Fair Hydro Trust, administered by the Ontario Power Generation (OPG) (two bonds were issued, one with a 15-year maturity and the other with a 20-year maturity). Under the new plan, this shortfall is paid to the IESO by a transfer from the provincial government on a monthly basis. The Treasury Board explained the bonds issued through the OPG Trust, through the Fair Hydro Trust, are still outstanding and all of their interest payments and principal payments will continue to be paid until the bonds mature. The transfer from the provincial government is now, and will continue to be, part of the fiscal plan and deficit, funded by the Ontario Financing Authority at a lower interest rate than the Fair Hydro Trust. The Ministry of Finance noted the borrowing for the Fair Hydro Plan was \$2.4 billion in 2018/19.

Committee Recommendation

The Standing Committee on Public Accounts recommends that:

- 4. The Province should formally document, publicly communicate, and then implement the long-term debt reduction strategy.**

LEGISLATED ACCOUNTING STANDARDS

The report stated the previous government passed legislation in 2008, 2009, 2011, and 2012 which gave it the ability to make regulations for specific accounting treatments rather than clearly accepting the application of independently established accounting standards, such as Canadian PSAS. The Auditor continued to express concerns about the government legislating a complex accounting/financing structure through the Fair Hydro Plan to improperly avoid showing an annual deficit and increases in net debt.

The Committee asked about the importance of Canadian PSAS. The Committee heard the Province remains committed to preparing its financial statements in accordance with generally accepted accounting principles. The Treasury Board Secretariat representatives explained that the Office of the Provincial Controller Division (OPCD) takes an active role in the standards-setting process by the Public Sector Accounting Board. The TBS stated it has made a number of significant recommendations and commentary on documents that would amend the standards over the past year, including new standards implementations coming into force in 2020/21 pertaining to the financial instrument standards.

Committee Recommendation

The Standing Committee on Public Accounts recommends that:

5. **The Province should amend Ontario Regulation 395/11 in the *Financial Administration Act* which could foster and encourage accounting treatments that vary from generally accepted accounting principles and amend the *Financial Administration Act* to convey in law clearly that the financial statements for the Province of Ontario will be prepared in accordance with Canadian Public Sector Accounting Standards (PSAS) in letter and spirit.**

GENERAL

Volume 2 of the Public Accounts of Ontario contains the individual financial statements of government organizations, business enterprises and other miscellaneous financial statements. The Committee expressed concern that for the year 2018/19 Volume 2 of the Public Accounts of Ontario is no longer available in print nor are the financial statements consolidated online.

Committee Recommendation

The Standing Committee on Public Accounts recommends that:

6. **The Office of the Provincial Controller Division (OPCD) should continue to print or provide an online substitute for the financial statements previously available in Volume 2 of the Public Accounts of Ontario and have this information accessible online simultaneously with the annual tabling of the Public Accounts. This online substitute should list all the entities which consolidate into the Province's financial statements and electronically link their respective financial statements.**

LIST OF COMMITTEE RECOMMENDATIONS

The Standing Committee on Public Accounts recommends that:

1. The *Auditor General Act* should be amended to
 - a. require government ministries, and agencies and crown corporations which are consolidated into the Province's financial statements to give advance notice to the Auditor General and ask for comment regarding external auditing firms they propose to hire to perform an audit or provide accounting advice; and
 - b. allow the Office of the Auditor General of Ontario to reject the proposed selection of external auditing firms hired to perform financial statement audits on agencies and crown corporations which are consolidated into the Province's financial statements, and those that provide accounting advice to government ministries or agencies and crown corporations.
2. The *Auditor General Act* should be amended to give the Office of the Auditor General of Ontario the authority and discretion to be the appointed financial statement auditor of agencies, organizations, and crown corporations consolidated into the Province's financial statements.
3. Treasury Board Secretariat should communicate to ministries, agencies, and crown corporations that any external auditing firm that audits the financial statements of a ministry, agency or crown corporation which consolidate into the Province's financial statements, and which is deemed material by the Office of the Auditor General of Ontario, shall not provide accounting advice or accounting advisory services for the ministry that the agency or crown corporation reports to, or to Treasury Board Secretariat, or to other ministries, agencies or crown corporations that may be involved in a related party transaction.
4. The Province should formally document, publicly communicate, and then implement the long-term debt reduction strategy.
5. The Province should amend Ontario Regulation 395/11 in the *Financial Administration Act* which could foster and encourage accounting treatments that vary from generally accepted accounting principles and amend the *Financial Administration Act* to convey in law clearly that the financial statements for the Province of Ontario will be prepared in accordance with Canadian Public Sector Accounting Standards (PSAS) in letter and spirit.

- 6. The Office of the Provincial Controller Division (OPCD) should continue to print or provide an online substitute for the financial statements previously available in Volume 2 of the Public Accounts of Ontario and have this information accessible online simultaneously with the annual tabling of the Public Accounts. This online substitute should list all the entities which consolidate into the Province's financial statements and electronically link their respective financial statements.**