Ontario: Auditor General's Review of the *2018 Pre-Election Finances Report*

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TWO EXPENSES CONSIDERED UNDERSTATED

- As anticipated, Ontario's Auditor General (here) concluded that the Liberal government's *Budget 2018* estimates for fiscal 2018–19 (FY19) to FY21, as replicated in the *Pre-Election Report,* were not a reasonable presentation of the Province's finances. Projected expenses were deemed understated by not reporting the full financial impact of the *Fair Hydro Plan's* electricity rate reduction and by underreporting overall pension expense (chart 1).
- The Auditor General's estimate of the two understated expenses would add $5.0 billion to FY19 expenditures, widening the Liberals' projected FY19 deficit of $6.7 billion to $11.7 billion.
- Restating expenditures back to FY15 for the understated expenses raises the government's estimate of Ontario's net debt as of March 2018 from 37.1% of GDP to 39.1% (chart 2).

THE TWO UNDERSTATED EXPENSES

The Office of the Auditor General already has discussed its concerns on the treatment of the power rate reductions stemming from the *Ontario Fair Hydro Plan Act, 2017*[1]. The electricity rate reductions are partially funded by borrowing to pay the power generators their contracted prices. Neither the expenses incurred to pay the power generators nor the interest on the funds borrowed are included in the *Budget 2018* expenditures. If the cost of the power rate reduction had been included as an expense rather than treated as a rate-regulated asset, Ontario's expenditures would be higher by $2.4 billion in FY19, $2.6 billion in FY20 and $2.8 billion in FY21.

The Auditor General also maintains that Ontario is underestimating its overall pension expense by $2.6 billion in FY19, $3.0 billion in FY20 and $3.2 billion in FY21 because of the recorded pension revenue from the Ontario Teachers' Pension Plan and the insufficient pension expense estimated for the Ontario Public Service Employees' Union Pension Plan.

For these two jointly sponsored pension plans, the accounting discussion has been ongoing since the *2015–16 Public Accounts.* In its final financial statements for FY16, Ontario accepted the Auditor General's recommendation with respect to its pension assets which arise when the government's total contributions to the plans since their inception, including interest earned, exceed the cumulative retirement benefit expenses. Ontario in prior years had recorded its pension assets to the extent that it expected to benefit from the pension asset through future contribution reductions. The Auditor General maintained that the Province had no legally enforceable right to unilaterally access jointly sponsored pension plan assets, nor did it have an irrevocable right negotiated with the plans' other sponsors to reduce the government's contributions. For FY16, the pension

Chart 1

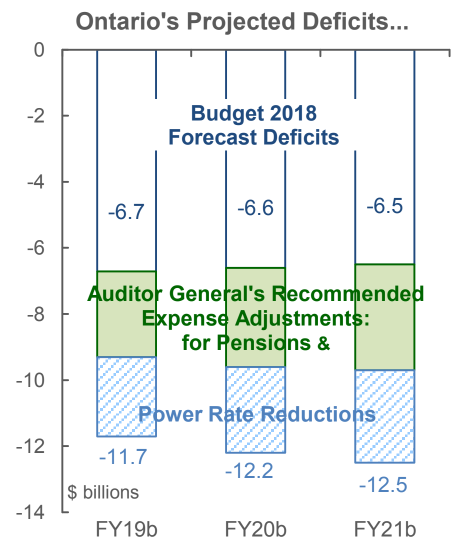
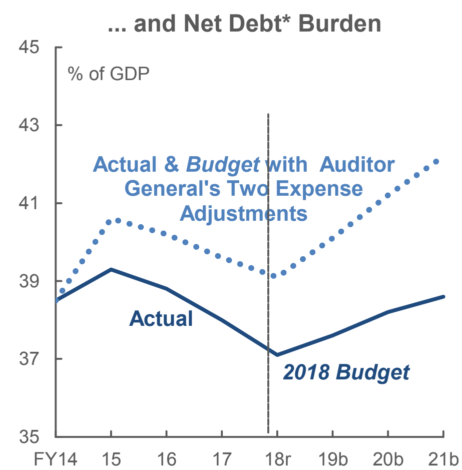


Chart 2



*Net debt and nominal GDP calculated by Ontario.
Source for charts: Office of the Auditor General of Ontario.

[1] In this review, the Auditor General's references to the *Fair Hydro Plan* exclude the Harmonized Sales Tax rebate and other taxpayer-funded programs.

accounting adjustment raised Ontario's year-end accumulated deficit and its net debt by $10.7 billion. For Ontario's annual operating budgets, the required Pension Adjustment was expected to rise from $1.5 billion in FY16 to $3.7 billion in FY19. In late 2016, Ontario established a Pension Asset Expert Advisory Panel to interpret the public-sector accounting standards relating to joint trusteed plans. The Panel recommended in early 2017 (here) that the Province's share of the net pension assets of its two large plans be recognized in Ontario's financial statements, returning the Province to its prior accounting practice.

Table 1

Budget 2018 Program Announcements
$ millions except where noted

	FY19	FY20	FY21	Total
New Initiatives				
Expanding OHIP+ to all seniors	0	373	577	**950**
Free Child Care (2½ - 4 years)	0	0	931	**931**
New Ontario Drug and Dental Program	9	294	508	**811**
Seniors: Support to Live Independently	0	350	350	**700**
Total: New Initiatives	**9**	**1,017**	**2,366**	**3,391**
Major Expansions of Existing Programs*				
Reform Social Assistance	329	727	1,253	**2,309**
Developmental Services: Enhanced Funding	194	492	682	**1,368**
Mental Health & Addictions: Further Support	189	417	634	**1,240**
Increased Access to Affordable Child Care	90	260	450	**800**
Investments to Reduce Hospital Wait-Times	129	129	129	**386**
K-12 Special Education: Improved Access	50	93	116	**259**
Total: Major Expansions of Existing Programs*	**981**	**2,118**	**3,263**	**6,362**
Other New Initiatives & Program Expansions*	1,324	894	1,109	**3,327**
Total Program Announcements	**2,314**	**4,028**	**6,739**	**13,081**
% of FY18 Estimated Program Spending	*1.7*	*2.9*	*4.9*	***9.5***

*Itemized if $100 mn or over. Base funding increases for existing programs not included.
Sources: Office of the Auditor General of Ontario, Ontario Treasury Board Secretariat.

THE AUDITOR GENERAL'S OTHER COMMENTS ON THE *2018 PRE-ELECTION FINANCES REPORT*

With the exception of the two major expense adjustments discussed above, the Auditor General generally considered the revenue, expenditure and debt service estimates in the *Pre-Election Report* to be based on cautious assumptions in line with Ontario's *Financial Transparency and Accountability Act, 2004 (*though the *2018 Report* detail was somewhat less than in the 2007 and 2011 *Pre-Election Reports).* Relative to prior years, the annual $700 million reserve from FY19 to FY21 to address unexpected events was somewhat lower and did not rise over time, but the cumulative FY19–FY21 capital and contingency funds of $7.9 billion was larger.

Future uncertainty was considered elevated with respect to compensation costs given upcoming contract negotiations over the next three years. The cost estimates for the major *Budget 2018* initiatives outlined in Table 1 also were judged uncertain due to the lack of program history to inform the estimates and the potential for behavioural shifts with the program changes and greater-than-expected uptake. A sizeable portion of the new spending is entitlement transfers not discretionary outlays.

A risk referenced for government business enterprises' projected income is Hydro One's appeal of an Ontario Energy Board rate decision. If its appeal is unsuccessful, FY19 revenues in the *Pre-Election Report* would be about $420 million lower based on the Province's ownership share in Hydro One.