

B.C. HYDRO'S 2018/19 ANNUAL REPORT: FLAT SALES BUT FINANCES NOW REFLECT GAAP

Last week the government released B.C. Hydro's annual report for 2018/19.¹ This paper reviews some of the financial and operational highlights of the year. The Appendix contains summary tables of certain aspects of the financial report.

1.0 Responding to the Auditor General's Criticism

The 2018/19 results reflect important changes made to B.C. Hydro's accounting practices in response to Auditor General Bellringer's criticism of the "prescribed" accounting system in place during her 2016/17 and 2017/18 audits of the government's financial statements.² The auditor general recommended that the government require B.C. Hydro to adopt the IFRS public sector accounting standard, which stipulates that an independent third-party oversee of the regulatory accounts. The regulatory accounts protect the shareholder (the government) from most financial risks and are vital to B.C. Hydro's finances.

Responding to the auditor general's criticism, the government ordered the public utility to adopt the IFRS standard and to close the Rate Smoothing (revenue deferral) Regulatory Account (RSRA). The corporation reported an operating loss of \$428 million because of the one-time write-off of approximately \$1.1 billion in the RSRA. Had the RSRA continued for the year the net income would have been approximately \$670 million.

2.0 Domestic Sales and Trade Income

Domestic electricity sales in the three main customer groups rose by only 439 GWh (0.9%) compared to the prior year, while surplus sales fell by 3,472 GWh (60.9%).³ Total domestic sales included surplus sales of 2,230 GWh, which was a 56% drop from the prior year's surplus sales.

Domestic sales revenue for the three major customer classes rose by \$157 million (3.3%) primarily because of a 3% rate increase effective on 1 April 2018.

¹ <https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/accountability-reports/financial-reports/annual-reports/BCHydro-Annual-Service-Plan-Report-2018-2019.pdf>

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_ndp_five_year_hc_hydro_plan_15_february_2019/pdf/commentary_ndp_five_year_hc_hydro_plan_15_february_2019.pdf and

<https://www.timescolonist.com/opinion/columnists/les-leyne-watching-b-c-hydro-is-a-growth-industry-1.23137605>

³ Residential and Commercial GWh sales were essentially flat, while the 3.4% increase in the Large Industrial class was due to the mid-year addition of the additional Waneta Dam GWh to the sales total.

3.0 Trade Income

Despite an 18% decline in GWh sales lower sales, the trade revenue jumped by \$410 million (56%) compared to last year because of a sharp increase in the average sale price. The relative shortage of electricity and the cold weather demands last winter significantly increased the average price of electricity.

4.0 Lower Water Levels

Last year was notable for the reduced snowpack and the resulting lower water levels in B.C. Hydro's reservoirs. The average water inflow was 87% of normal for 2018/19, compared to an average of 99.5% for the past four years.

The lower water levels in the Peace River and the Columbia River storage systems reduced the owned-power and the IPP generation and the sale of surplus electricity.

Operationally, BC Hydro fills its system storage during the spring and fall freshet, when inflows exceed loads. As B.C. Hydro explains;

The precise amount of refill depends on reservoir elevations at the end of winter, snowpack (and to a lesser extent, spring precipitation), generation from other resources (e.g., IPPs) and loads. BC Hydro monitors snowpack levels as the winter progresses and uses this information to inform operation (e.g., through expected water availability) for the upcoming seasons. While reservoir levels at the end of winter are largely dependent on load and start-of-winter elevations, BC Hydro is able to adjust end of period storage levels through market purchases and/or sales and thermal generation.⁴

By 31 March 2019, B. C. Hydro recorded system storage of GWh at only 7,293 GWh compared to 9,736 GWh for the prior year and 11,308 GWh for 2016/17.⁵

5.0 Regulatory Accounts

As of 31 March 2019, the net balance in the regulatory accounts was \$4.19 billion, which was a reduction of \$946 million from the prior year. The main additions and reductions in the regulatory accounts for the year were:

Regulatory Account	\$=million	Reason
Heritage Deferral	(95)	Lower costs
Non-Heritage Deferral	(170)	Lower IPP purchases, larger market purchases
Trade Income Deferral	(321)	Higher trade net income
Rate Smoothing	(815)	Elimination/wind-up
Net Amortization	(442)	
Debt Management	321	Hedging losses on interest rates

⁴ BCUC, B.C. Hydro F20-F21 RRA, IR1, BCUC 1.20.6 (pdf 310/2145);

https://www.bcuc.com/Documents/Proceedings/2019/DOC_54171_B-5-BCH-Response-to-BCUC-IR1.pdf

⁵ Ibid., BCUC 1.20.5.1 (pdf 307/2145).

Non-Current Pension	182	Lower discount rate on pension liability
Demand Management	111	All expenditures deferred

Source: B.C. Hydro 2018/19 Annual Report, p. 28.

The \$4.19 billion net balance of the regulatory accounts is recorded as an asset and represents about 85% of the equity. The ratio of net regulatory assets to equity was 94.8% in 2017/18, and reached a high of 133% in 2015/16.

B.C. Hydro plans to credit customers with approximately \$316 million of the accumulated liability in the Heritage deferral account to reduce the required rate increase for 2019 and 2020.

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The writer is a retired senior BC government public servant whose paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 was published by *BC Studies* in November 2016. *BC Studies* published his paper on the 40-year financial history of ICBC in 2013. He is an intervener in the BC Utilities Commission's current reviews of ICBC's and B.C. Hydro's rate requests.

APPENDIX

Domestic revenue increased by 4.0%, primarily because of a 3% rate increase effective 1 April 2018. Expenditures excluding trade energy and the change in regulatory accounts increased by 9.6% (\$459 million), with a major loss in debt hedging (finance charges) being responsible for most of the increase.

The \$1.1 billion swing in net income from the prior year was mainly due to the write-off of the Rate Smoothing (revenue) deferral account, which was instituted by cabinet order in 2014.

Table A1 – REVENUE AND EXPENDITURE SUMMARY (\$=million)

	2017/18	2018/19	Difference	Per Cent
Revenue				
Domestic	5,223	5,432	209	4.0
Trade	731	1,141	410	56.1
Total	5,954	6,573	620	10.4
Expenditures				
Domestic Energy	1,615	1,573	(42)	(2.6)
Trade Energy	522	624	102	19.5
Amortiz. & Depreciation	817	880	63	7.7
Grants & Taxes	241	268	27	11.2
Finance Charges	824	1,186	362	43.9
Other Operating Costs	1,302	1,351	49	3.8
Total	5,321	5,882	561	10.5
Regulatory Account Change	51	(1,119)	(1,068)	--
Net Income	684	(428)	(1,112)	--
Net Regul. Acc't Balance	5,140	4,194	(946)	(22.9)
Equity	5,421	4,934	(487)	(9.0)
Net Long-Term Debt	20,140	22,101	1,961	9.3

Source: B.C. Hydro 2018/19 Annual Report p. 114.

Table A2 shows that electricity sales were relatively flat compared to the prior year. The increase in sales in the Large Industrial group is inflated by the counting of the 2/3rds of the Waneta Dam production and sales which began part way through the year.

Surplus sales dropped by almost 3,500 GWh because of the curtailment of owned production due to lower reservoir levels.

Table A2 – SALES INCOME by CUSTOMER CLASS (\$=million)

	2017/18	2018/19	Difference	Per Cent
Residential	18,150	18,000	(150)	(0.8)
Lt. Ind. & Commercial	18,874	19,007	133	0.7
Large Industrial	13,440	13,896	456	3.4
Total	50,464	50,903	439	0.9
Surplus Sales	5,702	2,230	(3,472)	(60.9)
Other Sales	1,637	1,510	(127)	(7.8)
Total Domestic	57,173	54,643	(2,530)	(4.6)
Trade	34,595	28,158	(6,437)	(18.6)

Source: B.C. Hydro 2018/19 Annual Report p. 23.

The \$1.3 billion increase in capital expenditures in 2018/19 reflects the purchase of the remaining 2/3rds of the Waneta Dam. B.C. Hydro continues to spend significant amounts on capital projects for growth and expansion.

Table A3 – CAPITAL EXPENDITURES (\$=million)

	2014/15	2015/16	2016/17	2017/18	2018/19
Sustaining	1,005	1,136	1,286	1,190	965
Growth	1,164	1,170	1,158	1,283	2,861
Total	2,169	2,306	2,444	2,473	3,826

Source: B.C. Hydro annual reports, appendix on financial and operating statistics.

Free cash flow is a measure of how much cash a business generates after accounting for capital expenditures such as buildings or equipment. This cash be used for expansion, dividends, reducing debt, or other purposes. Table A4 shows that B.C. Hydro has not recorded a positive free cash flow for many years yet has paid dividends to the government.

Table A4 – FREE CASH FLOW and DIVIDEND (\$=million)

	2014/15	2015/16	2016/17	2017/18	2018/19
Free Cash Flow	(910)	(1,042)	(1,186)	(398)	(1,894)
Dividend	264	326	259	159	59

Source: B.C. Hydro annual reports.

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