

RECORDING UNEARNED REVENUE INOCULATES BC HYDRO'S PROFIT FROM COVID-19

The disruption to economic activity caused by the government's orders to control the COVID-19 pandemic are having serious consequences. Many service sector businesses – especially those in retail and hospitality – are shuttered. It seems that every few days governments are offering a new income support or cost deferral initiative to avoid a deep economic depression.

While many sectors of the economy are suffering, the steep drop in the number of vehicles on the road has resulted in a drop auto insurance claims. Many insurers are returning some of the windfall savings to their policyholders. ICBC has not yet disclosed any data on the drop in its claims costs.¹

Public transport services, such as BC Ferries and TransLink have cut services and employment to cope with massive losses in revenue. TransLink, which eliminated fares to allow rear door loading, has seen operating revenue drop by approximately 50%.² Early in April, BC Ferries estimated that its overall ridership had decreased by 80% across its network of routes.³

Premier Horgan is concerned about the worsening balance sheets of many of these public transport corporations. He has lobbied the federal government for financial relief, noting that when the economy begins to ramp up “we are going to need this public infrastructure in place and vibrant.”⁴

BC Hydro Losing Sales

Because of its reliance on regulatory (deferral) accounting Premier Horgan does not have to be concerned about BC Hydro incurring a major operating loss resulting from the drop in economic activity.

Our electric power utility has not released any data on the decline in its recent electricity sales due to the economic downturn. However, last week Manitoba Hydro stated that its

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_covid_19_rebates_8_april_2020/pdf/commentary_icbc_covid_19_rebates_8_april_2020.pdf

² <https://www.richmond-news.com/news/covid-19-translink-losing-75-million-a-month-seeks-emergency-funding-1.24117474>

³ <https://www.timescolonist.com/news/local/b-c-ferries-cuts-sailings-on-major-routes-suspends-service-on-others-1.24112289>

⁴ Interview by Simi Sara, CKNW, April 21, 2020, quoted in <https://vancouver.sun.com/opinion/columnists/vaughn-palmer-province-stretching-by-asking-ottawa-to-bail-out-b-c-ferries/>

overall electrical use (which includes residences, farms and commercial business) had dropped by 6%. A spokesman noted that the trend of reduced demand was being observed across North America.⁵

A 6% reduction on BC Hydro's domestic sales of approximately \$5.5 billion per year equates to a monthly loss of some \$27 million.⁶ If the suppressed level of economic activity were to last through April and May, the loss of revenue would be approximately \$55 million. As most of BC Hydro's costs are fixed in the short term, the lost revenue would normally reduce the planned \$712 million net income (profit) for 2020/21⁷ to about \$657 million.

Regulatory Accounting Protects BC Hydro's Profit

BC Hydro will not suffer any significant reduction in its planned net income for the current year despite the drop in its electricity sales. This magical result is made possible by BC Hydro's reliance on a variety of regulatory accounts which are used to defer cost and revenue variances between the budgeted and the actual results.

Normally, regulated utilities use rate regulated accounting to defer certain cost variances. In the last 10 years BC Hydro (either through cabinet edict or by the approval of the BC Utilities Commission) has greatly expanded the scope of these cost deferral accounts to reduce the risk of not achieving the net income target.

Of particular importance to the current drop in revenue caused by the measures to control the COVID-19 virus is BC Hydro's intention to record the lost revenue as revenue received. This recording of unearned income is not new. BC Hydro has been interpreting the BCUC's approval to defer cost of energy variances as "load" or revenue variances as early as 2008/09.⁸

In response to the COVID-19 revenue decline BC Hydro advised the BCUC that it will be recording the lost revenue to protect the profit target:

The extent and duration of the impacts of the pandemic on BC Hydro's revenues and costs are uncertain. However, BC Hydro's regulatory accounts will mitigate much of the uncertainty caused by the pandemic by capturing variances from forecast which can then be returned to or recovered from customers in the next test period in accordance with existing BCUC orders. For example:

⁵ <https://winnipeg.ctvnews.ca/pandemic-causes-drop-in-electricity-demand-across-the-province-manitoba-hydro-1.4905563>

⁶ In 2018/19 the domestic sales amounted to \$5.4 billion. Dividing \$5.5 billion (estimate for 2020/21) by 12 results in the \$460 million monthly estimate, with 6% being \$27.6 million.

⁷ The government ordered the BCUC to ensure that BC Hydro's rates would generate this profit target.

⁸ The BCUC only officially recognized this practice during the last rate review.

- Any impacts to cost of energy or load (e.g., potential declines in the commercial sector load) will be recorded in the Cost of Energy variance accounts.⁹

Using regulatory accounting to record unearned revenue increases BC Hydro's debt obligation. Instead of a drop in income, the deferral increases the debt obligation faced by future ratepayers. Little wonder that a former president of BC Hydro once stated that the regulatory account ensures a constant stream of net income, and that "it's very difficult for us to lose money in a given year."¹⁰

BC Hydro has been recording unearned income, and using the regulatory accounts to create regulatory assets to offset debt liabilities, for several years. However, does this conform to accepted accounting standards? The Ontario auditor general said it did not. Commenting on the deferral of revenue under the Ontario electricity rate reduction plan of 2017, she said that "A promise or commitment to raise revenue in the future is not an asset today" and "future revenue raised to pay off the debt should be recorded when it is earned—that is, when electricity is consumed by ratepayers."¹¹

Pending a clear decision by the BC auditor general, BC Hydro will continue to insulate its net income from losses resulting from the drop in economic activity.

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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 has been an intervener in the BC Utilities Commission's recent reviews of both ICBC's and BC Hydro's rate requests.

⁹ https://www.bcuc.com/Documents/Arguments/2020/DOC_57721_2020-04-01-BCH-FinalArgument.pdf p. 254 or Pdf 264/266

¹⁰ See <https://ojs.library.ubc.ca/index.php/bcstudies/article/view/187787/186354> p. 21.

¹¹ https://www.auditor.on.ca/en/content/specialreports/specialreports/FairHydroPlan_en.pdf p. 15.