

GOVERNMENT TAKES MAJOR STEP TO RESTORE INTEGRITY TO PUBLIC FINANCE: WHAT'S NEXT FOR B.C. HYDRO'S BOOKS?

The release of the 2017/18 public accounts heralded a positive development in the financial management practices of the provincial government. Finance minister Carole James and her cabinet colleagues should be applauded for recognizing that the B.C. Hydro's "prescribed" accounting standard did not conform to the national public sector accounting standards. This standard was the creation of the previous Liberal government and was unique among power utilities in North America.

Following the 2008 financial crisis the Liberal government exploited the deferral accounts at B.C. Hydro to suppress the true price for electricity while claiming high annual profits and dividends. The deferral of costs (and more recently unbilled and uncollected revenue) added to the already high debt liability faced by future B.C. Hydro customers.

The governments of B.C. and Ontario have controlled electricity prices for political advantage, and both lost in their bids for election (now the Liberal government of New Brunswick is attempting the same gambit).

The NDP government in this province has decided that bringing B.C. Hydro's accounting in from the cold is the better policy compared to dismissing the issue as a squabble between accountants. The question is whether the \$950 million that finance minister Carole James set aside as a prospective adjustment is enough to fix the problem, or must the government find another \$5.46 billion to eliminate all the regulatory assets and liabilities as suggested by auditor general Carol Bellringer.¹

The Lack of an Independent Regulator

The American accounting standard used by B.C. Hydro and many other Canadian power utilities is acceptable under Canadian accounting standards. A fundamental aspect of that standard is that the deferral of certain costs for inclusion in future rates (regulatory accounting) can only be done with the approval of an independent regulator.

¹ <http://www.bcauditor.com/sites/default/files/publications/reports/OAGBC%20-%20Final%20Report%20-%20Understanding%20our%20Audit%20Opinion%20on%20BCs%202017-18%20Summary%20Financial%20Statements.pdf> p. 15.

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A year ago, auditor general Carol Bellringer cited the lack of an independent regulator as one of the reasons to qualify the government's 2016/17 financial statements. At that time the government essentially agreed that it set the electricity rates.³ This year the government acknowledged that the non-conformity with GAAP was a problem and set aside \$950 million as a form of down payment to fix the problem.

Other Failings

Auditor general Bellringer has focused her objection on the most obvious failing of the current accounting practice. But she could have added two other points of failure; the lack of a reasonable plan to pay down the deferrals (the current plan is unrealistic)⁴, and the recording of unbilled and uncollected revenue (which was highlighted by the auditor general of Ontario).⁵

A Short History

In 2010 the Liberal government exempted B.C. Hydro from the need to have its deferral accounts approved by the B.C. Utilities Commission (BCUC), which was designated as B.C. Hydro's regulator.⁶

While the Liberal government had been chipping away at BCUC's independence the most obvious end of its discretion came in 2012, when the government set B.C. Hydro's rate increase for 2012 and 2013.

The highly prescriptive cabinet order of early 2014 (Direction 7) ordered the BCUC to, among other things, set the rate increases for 2014 to 2018.

² See <http://www.bcpolicyperspectives.com/blog/posts/bc-hydro-rate-suppression-and-debt> for a general overview, and <http://www.bcpolicyperspectives.com/blog/categories/bc-hydro> for other articles on the accounting issue.

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_44_26_october_2017/pdf/occasional_paper_no_44_26_october_2017.pdf

⁴ The lack of a plausible repayment plan was the main criticism of former auditor general John Doyle in 2011 see

⁵ <http://www.bcpolicyperspectives.com/blog/posts/what-would-ontarios-auditor-general-make-of-bc-hyd>

⁶ For a summary of the manipulation see

http://www.bcpolicyperspectives.com/media/attachments/view/doc/article_bcuc_june_10_2016_excerpts/pdf/article_bcuc_june_10_2016_excerpts.pdf also my final argument to the BCUC of June 8, 2017;

http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_bc_hydro_final_submission_june_8_2017/pdf/bcuc_bc_hydro_final_submission_june_8_2017.pdf

In a June 2016 letter to the auditor general Adrian Dix questioned whether the BCUC's lack of independence meant that the deferral accounts at B.C. Hydro did not conform to the required accounting standard. While the response was non-committal, a year later Ms Bellringer added the lack of an independent regulator of B.C. Hydro as a reason to qualify the government's 2017/18 financial statements.

The current government has not rescinded the 2010 exemption to the requirement for an independent regulator.

It is interesting that the credit rating agencies generally ignored the lack of conformity to GAAP and the high deferral-induced debt level at B.C. Hydro. They contented themselves with the belief that B.C. Hydro could raise electricity rates to cover the higher debt service costs – exactly what the previous government was attempting to avoid!

Next Steps

Finance minister James acknowledged that the \$950 million prospective adjustment does not rectify the previous government's misuse of deferral accounting: "This doesn't fix the problem that was left to us. But it is a significant step that we have taken to show that we recognize that it's a problem and that we aren't ignoring the challenge for future ratepayers and future generations."⁷

Ms Bellringer has promised to publish a detailed review of the regulatory accounting at B.C. Hydro in a few weeks. Her position is clear; as long as B.C. Hydro is exempt from the oversight of an independent regulator all the regulatory assets and liabilities must be eliminated.

As noted by Rob Shaw, this presents the government with a dilemma.⁸ To unshackle the BCUC could result in the Commission disapproving many of the current deferral accounts (such as the rate smoothing account, the pension deferrals and the recording of uncollected revenue) that it was ordered to approve. Setting rates based on the cost of service model would mean significantly higher electricity rates. This conflicts with the government's priority of affordability for the citizens of the province. Or, it could drastically reduce the return on equity (because the deferrals lower the risk) thereby lowering B.C. Hydro's net income.

If the cabinet continues to set electricity rates the auditor general's requirements would require the government to add some \$4.5 billion to the direct debt,⁹ and transfer this money to B.C. Hydro to eliminate the regulatory assets and liabilities. B.C. Hydro's rosy

⁷ As quoted in <https://vancouver.sun.com/opinion/columnists/vaughn-palmer-ndp-makes-impressive-start-managing-b-c-s-finances>

⁸ <https://vancouver.sun.com/news/politics/political-directives-have-undermined-b-c-hydro-s-finances-auditor-general-says>

⁹ The net deferral balance for 2017/18 was \$5.45 billion less the \$950 million prospective adjustment.

scenario financial forecast says that an average annual rate increase of 2.6% will avoid the need to increase the value of the net deferrals.¹⁰

The third option is to estimate the increase in the net deferrals since the BCUC lost its independence. If the 2012 cabinet order to set the annual rates is chosen as the cutoff point the additional increase to the direct debt would be approximately \$2.0 billion.¹¹

The next steps in this important restoration of financial integrity will be observed with great interest.

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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.

¹⁰ Before the net losses from Site C hit the books.

¹¹ The net balance of \$5.45 billion in 2017/18 less \$2.47 billion in 2011/12 less the \$950 million adjustment.