

IS THE GOVERNMENT AGAIN ON A COLLISION COURSE WITH THE AUDITOR GENERAL OVER BC HYDRO ACCOUNTING?

Recent cabinet orders have set the government on a collision course with Auditor General Michael Pickup by again demonstrating the lack of independence of the BC Utilities Commission (BCUC). It is possible that the issue will result in the auditor general qualifying the government's financial statements.

On 15 July 2024, the provincial cabinet approved an Order-in-Council (OIC 485/24) directing the BCUC to set BC Hydro's electricity rates to produce a net income of \$712 million for fiscal years 2025/26 and 2026/27. A week earlier, the government ordered the Commission to approve (OIC 441/24 of 7 July 2024) special electrification rates for the public power utility.

This paper will outline the issue, past accounting problems, and what we might expect because of the provincial government failing to follow national accounting standards.

Public Sector Accounting Standards

Rate-regulatory accounting, where variances between budgeted and actual revenue and expenditures are deferred to future year rates, is the foundation of BC Hydro's finances. Deferring variances between budgeted and actual revenue and expenditures smooths changes in the annual price of electricity.

Relative price stability is an important consideration for a pricing system based on actual costs and revenue. BC Hydro has far more of these deferral accounts than any other public or private power utility in Canada. The large number of deferral accounts means that ratepayers eventually pay actual costs, as BC Hydro often asserts to justify their use. Another interpretation is that by deferring practically all revenue and expenditure variances the accounting system dramatically lowers the risk of achieving the annual net income (profit) target, and indirectly the return on equity (ROE), mandated by the provincial government.¹

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https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_bc_hydro_deferrals_7_july_2024/pdf/commentary_bc_hydro_deferrals_7_july_2024.pdf

The BC government is required to adhere to national public sector accounting standards. These standards allow rate-regulated accounting, but only where the deferral accounts are approved and overseen by an independent third-party regulator. The BC Utilities Commission (BCUC) has the statutory authority to oversee the operation of BC Hydro, including the rate regulated deferral accounts.

Is the BC Utilities Commission Independent?

Section 3 of the Utilities Commission Act allows the provincial government to issue directions to the BCUC.² In the last 15 years the provincial government has often used this direction-setting authority require the BCUC to approve various measures to establish deferral accounts, approve capital projects and approve net income targets. These actions clearly demonstrated that the BCUC was not independent regarding its oversight of BC Hydro.

Former BC Auditor General Carol Bellringer cited the lack of independence of the BCUC in qualifying the BC government's financial statements for 2016/17 and 2017/18. In essence, she determined that the government had been circumventing national public sector accounting standards by allowing B.C. Hydro to use rate-regulated accounting without an independent third-party regulator (dubbed the "prescribed" accounting system). The previous Liberal government had been restricting the discretion of the BCUC to oversee the operation of B.C. Hydro for some time prior to a cabinet direction of 2012 which required the Commission to set general rate increases at levels determined by the government. In 2014, the government issued a highly prescriptive direction (Direction 7) to the BCUC which set rate changes for the next five years, including the requirement to approve a new deferral account to record future unbilled and uncollected revenue.³

In early 2019, in conjunction with the release of the Comprehensive Review Phase 1 staff report, the government rescinded the highly prescriptive Direction 7 to the BCUC and replaced it with a less restrictive order. The new directive did not fully restore the BCUC's independence because it still required the regulator to set rates to generate \$712 million in net income until 2022/23. However, the Phase 1 Review of February 2019 stated; "As an outcome of Phase 1 of the Review, the government will re-empower the BCUC to set BC Hydro's allowed net income, following a two-year transition period for Fiscal 2020 and Fiscal 2021 where BC Hydro's allowed net income of \$712 million will remain in place."⁴

² https://www.bclaws.gov.bc.ca/civix/document/id/rs/rs/96473_01#section003

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https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_auditor_general_remove_s_qualification_19_july_2019/pdf/commentary_auditor_general_removes_qualification_19_july_2019.pdf

⁴ https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bc-hydro-review/final_report_desktop_bc_hydro_review_v04_feb12_237pm-r2.pdf

It was assumed that beginning in fiscal year 2021/22 the BCUC would have full discretion to set an appropriate ROE and the resulting net income.⁵

Ms. Bellringer noted these positive changes in her July 2019 explanation as to why she withdrew her qualification of the government's 2018/19 financial statements. Bellringer stated that her withdrawal of the qualification was based on the promised independent "framework" for the BCUC; "Government's plans provide for an appropriate regulatory framework, and allow BCUC to provide the scrutiny and authority required by the accounting standards." Later in the document she again referred to the planned independence of the regulator: "With these changes in government regulation and direction, the removal of the RSRA, and government's commitment to restore the authority of the BCUC [my emphasis], we agree with government's assessment that BC Hydro's use of rate-regulated accounting is now appropriately reflected in the SFS [summary financial statements], and have therefore removed our qualification for this year."⁶

Having had the qualification lifted, however, the government failed to deliver on its promise to allow the BCUC to determine an appropriate ROE and net income. Cabinet continued issue directives to the BCUC to approve a \$712 million net income target for the years 2021/22 to 2024/25.⁷ Other directives to the Commission also over-rode its nominal independence.

Auditor General's Warning

In November 2022, as one of his first acts Premier David Eby announced an electricity rebate funded by a new BC Hydro deferral account. The BCUC was directed (OIC 571/22) to approve the new account.⁸

In reviewing BC Hydro's third quarter report Auditor General Michael Pickup noted that because the government ordered the BCUC to approve the new customer credit (rebate) deferral, the regulator had not been able to review the regulatory account. As a result: "When government issues a direction to BCUC, it prevents BCUC from applying its regulatory framework to review these amounts. As such, these amounts have not been subject to rate regulation and should not be accounted for in regulatory balances."⁹

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https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_bc_hydro_net_income_directive_11_march_2022/pdf/commentary_bc_hydro_net_income_directive_11_march_2022.pdf

⁶ Ibid.

⁷ The BCUC initiated a review of the ROE in 2021 in anticipation of having its authority restored;

https://docs.bcuc.com/documents/proceedings/2023/doc_73455_a32g23723gcocstage2timetable.pdf

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https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_bcuc_independence_5_december_2022/pdf/commentary_bcuc_independence_5_december_2022.pdf

⁹ <https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/accountability-reports/financial-reports/quarterly-reports/bchydro-f23-q3-report.pdf> p. 15.

In March 2024, the auditor general released a document that highlighted “areas of interest” in the government accounts, including rate-regulated accounting at BC Hydro.¹⁰ The auditor general focused on the government directives to the BCUC.

Government issues directions to the BCUC specific to BC Hydro under Section 3 of the Utilities Commission Act. Some of those directions have either bypassed or overridden the BCUC’s standard regulatory review process for setting rates. As a result, rate-regulated accounting may not be appropriate for the transactions that arose from the directions... **There is a risk the cumulative impact of directions could make it inappropriate for BC Hydro to continue to apply rate-regulated accounting.**” [my emphasis]¹¹

The auditor general had this to say about the government’s continuing directions to the BCUC directing the amount of BC Hydro’s net income.

Due to long-standing government net income directions, the regulator hasn’t been able to conduct a regulatory proceeding to determine a reasonable rate of return on equity (earnings) for BC Hydro.

While we don’t consider BC Hydro to be offside with rate-regulated accounting standards **this year**, net income directions are a future risk area that government and BC Hydro should actively monitor **to avoid losing the ability to apply rate regulated accounting.** [my emphasis] With government’s current net income direction to BC Hydro set to expire in March 2025, BC Hydro will apply to the BCUC to determine its allowed earnings for fiscal years beginning April 2025.¹²

Despite this clear warning the BC government has been unable to break its habit of micromanaging BC Hydro’s finances through cabinet orders to the BCUC.

Will the Auditor General Act?

The recent directives to the BCUC have drawn some public criticism. Vaughn Palmer, of the *Vancouver Sun*, reviewed the government’s actions in ignoring the warning of the auditor general. His analysis was aided by a recent opinion piece by former BCUC

¹⁰ <https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/accountability-reports/financial-reports/quarterly-reports/bchydro-f23-q3-report.pdf>

¹¹ <https://www.oag.bc.ca/sites/default/files/publications/reports/OAGBC-BCs202223SummaryFinancialStatementsAreasofInterest-Report-March2024.pdf> , p. 10. See also https://www.bcauditor.com/sites/default/files/publications/reports/OAGBC_RRA_RPT.pdf

¹² *Ibid.*, p. 12.

commissioner Richard Mason.¹³ Nelson Bennett of *Business in Vancouver* has also commented on the government's willingness to direct the BCUC respecting the finances of BC Hydro and ICBC.¹⁴

The NDP government has been promising to restore the independence of the Commission to regulate BC Hydro, and by extension the oversight of the deferral accounts. Yet the government's default setting appears to be to ignore the auditor general's warning and hope for the best. This may have been the thinking behind the July 6th and July 15th OICs.

The other alternative is that the government hopes that the auditor general will not qualify the 2023/24 financial statements and wait to qualify the 2024/25 accounts. This will avoid any financial embarrassment in the run-up to the October election.

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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 reviews of ICBC's and BC Hydro's rate requests.

¹³ <https://vancouver.sun.com/opinion/columnists/the-independence-of-the-bcuc-again-ignored-by-the-ebc-cabinet> see also <https://justandreasonable.com/bcuc-bypassed-again-as-government-legislates-bc-hydro-net-income/>

¹⁴ <https://www.biv.com/news/economy-law-politics/governments-use-crown-corporation-funds-questioned-8269995>