

WHAT WOULD THE ONTARIO AUDITOR GENERAL MAKE OF BC HYDRO'S "PRESCRIBED" ACCOUNTING STANDARD?

Ontario Auditor General Bonnie Lysyk recently released a special report that concluded that a key component of the Ontario government's electricity rate subsidy model violated Canadian public sector accounting standards. By creating its own accounting rules to hide billions of dollars of debt, the Liberal government was creating a unique standard and making its financial statements unreliable.¹

This paper explores the Ontario auditor general's opinion, and states that she would find the same violations of the accounting rules apply in British Columbia.

THE ONTARIO RATE SUBSIDY

In recent years electricity prices in Ontario have increased dramatically, and were expected to increase at high rates for years to come. The rise in electricity prices, driven by the addition of some \$50 billion in costs related to system refurbishment and the high cost of privately produced renewable power, caused a serious drop in public support for the Liberal government, which is facing an election in 2018.²

In hopes of diffusing the issue, the government passed legislation to reduce the 2017 rates by 25%, and moderate the growth in rates until 2027. The major components of the "Fair Hydro" are the a) the elimination of the provincial HST (8%), b) the transfer of two subsidy programs from the ratepayers to the taxpayer, and c) a 10-year rate smoothing plan to cap rate increases at the rate of inflation for the first four years, and held at higher cap for the next six years.

From 2028 to 2045, electricity customers would face higher rates to pay down \$39.4 billion in debt and interest costs accumulated to re-engineer the rates (because the energy producers would continue to receive the full cost of production).

Rather than show the accumulated borrowing and interest on the government's financial statements, the Liberals passed legislation to create a regulatory deferral account in a separate Crown entity. Because there is an expectation of a revenue stream to recover the debt, regulatory accounting allows the debt liability to be balanced off by creating an asset of equal value. Therefore, the government will show no net change to equity.

It was the creation of this regulatory deferral account that drew the ire of the Ontario Auditor General.

¹ http://www.auditor.on.ca/en/content/specialreports/specialreports/FairHydroPlan_en.pdf

² <http://www.cbc.ca/news/canada/toronto/ontario-hydro-bills-global-adjustment-kathleen-wynne-1.3975946>

She found two critical flaws in the scheme; the lack of an independent third-party regulator, and anticipated future revenue cannot be recorded until the electricity is consumed and the revenue is actually received.³ On both counts the Liberal government's plan, which masked the true debt position, violated generally accepted accounting practices, thereby making the government's financial statements unreliable.

Ms. Lysyk used plain language to describe the Ontario government's accounting ploy:

The substance of the issue is straightforward. Ratepayers' hydro bills will be lower than the cost of the electricity used as a result of the electricity rate reduction. However, power generators will still be owed the full cost of the electricity they supply, so the government needs to borrow cash to cover the shortfall to pay them. The effects of the additional debt required to fund the generators need to be accounted for as part of the annual deficit and net debt of the Province. However, the government did not properly account for this debt impact from the electricity rate reduction in its 2017/18 budget and is not planning to account for it properly in its future consolidated financial statements. In essence, the government is making up its own accounting rules.

Her report led to critical media comments. David Reevely of the *Ottawa Citizen* likened the accounting scheme as part of the post-truth government environment; "... the tricks the government is using throw doubt on all the province's books. The government, citizens, auditors and giant institutions that lend the province money are pretty much operating in a post-truth universe, where what the Liberals say is going on with Ontario's finances has begun to drift from any previously understood shared reality."⁴

The government, as expected, disagreed with the auditor general's findings, dismissing the matter as a squabble between accountants.

THE HYDRO RATE SUBSIDY IN BRITISH COLUMBIA

Subsidizing electricity prices through regulatory/deferral accounts is nothing new in this province; in fact, the former Liberal government literally wrote the play book.

If Ms. Lysyk examined the 'prescribed' accounting standard at BC Hydro she would find the same abuse of regulatory/deferral accounting, and the recording of unbilled and uncollected revenue.

The BC Utilities Commission, the nominal regulator of BC Hydro's rates, is not independent as required by the American regulatory accounting standard used to create the regulatory/deferral accounts.⁵ In 2011, anticipating this criticism prior to relieving

³ The Auditor General stated 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." P.15

⁴ <http://ottawacitizen.com/news/local-news/reevely-hiding-billions-in-hydro-debt-unacceptable-ontarios-auditor-general-says>

⁵ http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_15_bcuc_independence_27_october_2016/pdf

the Commission of its rate setting authority in 2012, the Liberal government exempted BC Hydro from this fundamental tenet of the accounting standard.⁶

Ms. Lysyk would fail the accounting practices on this basis alone.

BC Hydro is recording and deferring unbilled and uncollected revenue to inflate its annual net income, and its equity. While Ontario is now venturing into this new territory, it is following the path explored by the BC government and BC Hydro.

In 2014, as part of the 10-year financing/rate plan, the government ordered the BC Utilities Commission to approve a “rate smoothing” deferral account to record the difference between the annual require revenue and that produced by the lower government-mandated rates. By 2020/21, BC Hydro forecasts that almost \$1.6 billion in deferred revenue will be housed in this account.⁷

In addition, BC Hydro has been recording the annual shortfall between the forecasted and actual revenue, and deferring this amount in a separate deferral account intended to defer cost variances. From 2008/09 to 2015/16, almost \$1.0 billion in unbilled and uncollected revenue had been recorded in this account.

In June 2016, opposition critic Adrian Dix asked BC Auditor General Carol Bellringer whether this “audacious attempt to use deferral accounts to mislead the ratepayer and the taxpayer as to the true state of government finances” conforms to generally accepted accounting principles.⁸

The BC Auditor General said her office was monitoring the situation, and that Dix’s questions would be included within the scope of an audit of the regulatory accounts sometime in the next three years.⁹ A far different response than the opinion delivered by her Ontario counterpart last week.

Since the Dix query, more highly questionable accounting practices have come to light. In addition to the rate smoothing revenue, BC Hydro has been recording the annual shortfall between the forecasted and actual revenue, and deferring this amount in a separate deferral account intended to defer cost variances.

During the current rate review, BC Hydro confirmed that from 2012/13 to 2015/16 a further \$790 million, including some \$470 million in the last two years, in unbilled and uncollected revenue was booked in this separate deferral account.¹⁰

⁶http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_21_30_january_2017/pdf

⁷ http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_25_12_march_2017/pdf

⁸ http://www.bcpolicyperspectives.com/media/attachments/view/doc/adrian_dix_to_auditor_gen_june_8_2016/pdf

⁹ http://www.bcpolicyperspectives.com/media/attachments/view/doc/auditor_gen_reply_to_dix_june_28_2016/pdf

¹⁰

http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_bc_hydro_final_submission_june_8_2017/pdf p. 3.

When asked by the BCUC whether this practice conformed to generally accepted accounting principle, BC Hydro replied that it conformed to the government's direction.¹¹

SUMMARY

The Auditor General of Ontario has condemned the accounting device created by the Ontario government to circumvent the requirement to properly show the governments debt and financial position.

So what's the bottom line? I would not be doing my job as Auditor General if I said that creating assets through legislation is acceptable. Under this Bill, the government's policy decision to borrow money to subsidize electricity bills will not affect the Province's net debt or annual deficit. This legislated accounting is not in accordance with Canadian public-sector accounting standards. These standards are there to ensure that the financial reporting of government policy decisions reflects common sense: borrowings are debt; unearned revenue is not an asset today; and when your expenses exceed your revenues, you incur a deficit. Such common sense and the principle of substance over form should prevail in the financial reporting of government policy decisions.¹²

The BC government, through various directives to BC Hydro and the BC Utilities Commission, has been circumventing public sector accounting standards for years. The 2014 rate smoothing deferral account was designed to allow the subsidization of electricity rates, but it was more blatant than the Ontario model in that no future source of funding was identified, as I noted in my 8 June 2017 arguments to the Commission.¹³

What would the Ontario auditor general make of the post-truth accounting practices employed at BC Hydro? One can safely assume that Ms. Lysyk would quickly arrive at the same conclusion as she did in her 17 October 2017 special report respecting the Ontario scheme.

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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 ICBC's rate requests, and is an intervener in the Commission's current review BC Hydro's rate request.

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/accounting_rules_email_from_richard_mccandless_to_carol_bellringer_2_dec_2017/pdf

¹² http://www.auditor.on.ca/en/content/specialreports/specialreports/FairHydroPlan_en.pdf p. 37.

¹³

http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_bc_hydro_final_submission_june_8_2017/pdf pg. 4-5.

