

BC AUDITOR GENERAL SAYS GOVERNMENT SHOULD RECIND BC HYDRO'S 'PRESCRIBED' ACCOUNTING STANDARD

On 22 October 2017, I circulated Occasional Paper No. 43 which compared Ontario Auditor General Bonnie Lysyk's objections to the accounting method being used by the Ontario government to subsidize electricity rates with the 'prescribed' accounting standard currently employed at BC Hydro to accomplish the same objective.¹

On 24 October 2017, *The Tyee* published my article "Will NDP End BC Hydro's 'Wild West' Accounting?" which summarized the material in the occasional paper.² The next day *The Tyee* published Andrew MacLeod's summary of his interview with finance minister Carole James, where she said the NDP government was taking steps to fix BC Hydro's accounting practices.³

Yesterday, BC Auditor General Carol Bellringer advised me that, for the first time, she cited the "inappropriate" use of regulatory accounting at BC Hydro as one of the reasons why she gave a qualified opinion on the government's 2016/17 public accounts.⁴ Not content to have her qualification noted in the August public accounts document, the auditor general followed up some weeks later with a separate report on her reasons for issuing the qualifications.⁵

OBSERVATIONS AND IMPLICATIONS

In recent years the BC auditor general has disputed the government's interpretation of the national public sector accounting standards related to the timing of revenue recognition of certain transfers. However, this year the auditor general added an important reason to qualify the government's presentation of the 2016/17 financial statements. She found that the regulatory accounting at BC Hydro is not acceptable because of the lack of an independent third-party regulator.⁶

¹ http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_43_22_october_2017/pdf

² https://thetyee.ca/Opinion/2017/10/24/Will-NDPEnd-BC-Hydro-Wild-West-Accounting/?utm_source=daily&utm_medium=email&utm_campaign=241017

³ https://thetyee.ca/News/2017/10/25/Fixing-BC-Hydro-Accounting/?utm_source=daily&utm_medium=email&utm_campaign=251017

⁴ http://www.fin.gov.bc.ca/ocg/pa/16_17/Public%20Accounts.pdf The accounts were released on 22 August 2017.

⁵ http://www.bcauditor.com/sites/default/files/publications/reports/FINAL_ROPA_2016_17.pdf

⁶ *Ibid.*, pg. 11 and 12.

The requirement for an independent regulator is fundamental to the application of the American regulatory accounting standard which allows the use of deferral accounts to smooth changes to electricity rates. In 2011, the government exempted BC Hydro from the need for an independent regulator (the BC Utilities Commission) to approve regulatory (deferral) accounts. This lack of an independent regulator was one of the reasons cited by Ontario's auditor general in her criticism of the new rate subsidization scheme in that province.

Beginning in 2012, the BC government has set BC Hydro's annual electricity rate increases below the level required to match the increase in the utility's costs. In 2014, as part of a highly prescriptive cabinet order, the Crown corporation was required to record and defer unbilled and uncollected revenue in a new "rate smoothing" deferral account to continue the annual rate subsidy and still produce high net income levels.

These prescriptive cabinet directives led Rowland Harrison, one of Canada's experts on regulatory oversight, to state in November 2014 that the BC Utilities Commission was being reduced to acting as an agent of the BC cabinet.⁷

Auditor General Bellringer is to be complimented for stating that the 'prescribed' accounting standard used by BC Hydro is inappropriate and should be rescinded by the government. While BC Hydro's unique accounting standard has been in place for two previous fiscal years, and did not draw her attention, her opinion is now aligned with that of her counter-part in Ontario.⁸

Auditor General Bellringer also gave notice that a more detailed report on rate regulated accounting, "which we hope will assist in the understanding of this complex subject," is planned for release in 2018.⁹ One hopes that this report will look more closely at the revenue recognition practices utilized by BC Hydro, specifically the rate smoothing and non-heritage revenue deferrals. Additionally, by deferring practically all cost and revenue variances, government as the single shareholder avoids all risk, yet still demands a high return on equity (which is comprised of the net deferral assets).¹⁰

The auditor general's finding that the regulatory accounting at BC Hydro does not conform to generally accepted accounting principles has major implications for the government's current 10-year electricity rate subsidy plan, and the current cabinet-mandated net income target for BC Hydro. Some of these are discussed in my 8 June 2017 submission to the BC Utilities Commission.¹¹

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_15_bcuc_independence_27_october_2016/pdf p. 3.

⁸ The issue of the lack of an independent regulator, and the recording of unbilled and uncollected revenue was raised by NDP critic Adrian Dix in June 2016, and more information was supplied by the author on 2 December 2016, see http://www.bcpolicyperspectives.com/media/attachments/view/doc/accounting_rules_email_from_richard_mccandless_to_carol_bellringer_2_dec_2017/pdf

⁹ http://www.bcauditor.com/sites/default/files/publications/reports/FINAL_ROPA_2016_17.pdf p. 14.

¹⁰ An independent regulator would significantly lower the shareholder ROE to reflect the lack of risk.

¹¹ http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_bc_hydro_final_submission_june_8_2017/pdf

The response to the auditor general's opinion on the use of regulatory accounting at BC Hydro, the comments by the government's comptroller general are illuminating.

In this report the Auditor General notes that the accounting standard for rate regulated accounting provides for the regulatory actions of an independent regulator, or the entity's own governing board if it is so empowered by statute or contract. With regard to the Public Accounts of British Columbia, cabinet is the governing board of the government and has been empowered by the *BC Hydro Public Power Legacy and Heritage Contract Act* to make rate regulating decisions as required by the accounting standard.¹²

In effect, the comptroller general is confirming that the BC Utilities Commission is an agent of cabinet, and that the government can adopt whatever accounting standard it chooses, or – as evidenced by the 'prescribed' standard at BC Hydro – invent one to suit the immediate need.

As Auditor General Lysyk noted: "When governments pass legislation to make their own accounting rules that serve to obfuscate the impact of their financial decisions, their financial statements become unreliable."¹³ She went on to explain that

A government should not record on its own set of statements or have its statements impacted by an asset it creates under legislation. In essence, the government is making up its own accounting rules. Further, a regulatory asset cannot be recorded on financial statements prepared using the Canadian Public Sector Accounting Standards framework. We obtained extensive advice confirming these points from the current Auditors General in Canada, a former Auditor General of Saskatchewan and British Columbia and external advisers, including, but not limited to, the recently retired Director of the Canadian Public Sector Accounting Board.¹⁴

It is strange and troubling that the BC auditor general's new and important qualification to the government's public accounts for 2016/17 should be issued without any reaction or comment by the provincial news media. Perhaps the members of the fourth estate were too anxious speculating about the disposition of the potential surplus inherited by the new NDP administration to bother reading the footnotes?

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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.

¹² Ibid., p. 7.

¹³ http://www.auditor.on.ca/en/content/specialreports/specialreports/FairHydroPlan_en.pdf p. 5.

¹⁴ Ibid., p. 17.

