



Assessment Note

Office of the Provincial Controller Division
Financial Reporting and Fiscal Support Branch

Adopting the Accounting Recommendations of the Auditor General – Fair Hydro Plan

Issue:

Describe the options for adopting accounting treatment for the Fair Hydro Plan as recommended by the Auditor General.

Overview:

Market Accounts - Independent Electricity System Operator - (IESO)

As a counterparty to the contracts between power generators and local power distributors, there are settlement balances arising at the end of the fiscal year. In 2017, the IESO changed their accounting to record these balances (which net to NIL on the balance sheet) in their financial statements.

Fair Hydro Plan

The Fair Hydro Plan was passed in May 2017. As part of the Fair Hydro Plan's policy objectives to reduce consumer hydro bills by 25%, a portion (approximately two-thirds) of this reduction was achieved through redistributing the timing of recovery from ratepayers for the investments in green energy through contracts with power generator currently in effect. This deferral creates a shortfall which must be made up through borrowing (to fulfill the contractual obligations to power generators). The future recovery from ratepayers will occur through the introduction of a dedicated charge (the Clean Energy Adjustment (CEA)) to consumers' electricity bills starting in 2022.

In the regulated sectors, companies in Canada are currently permitted under a transitional provision in private-sector accounting standards (International Financial Reporting Standards or US GAAP) to defer recognition of expenses where recovery is expected from customers. This is referred to as "rate-regulated accounting". In Ontario, both Ontario Power Generation and Hydro One use the approach. Public Sector Accounting Standards are silent on the use of rate-regulated accounting. In such cases, professional judgment is applied to assess the nature of the transaction and the most appropriate representation of the circumstances using sources of accounting guidance issued by other accounting bodies. In evaluating other sources, the principles adopted must be consistent with the concepts of Public Sector Accounting Standards (e.g. definition of an asset). In this case, the application of rate-regulated accounting by the Independent Electricity System Operator was determined appropriate as this entity is industry regulated (by the Ontario Energy Board) the application of rate-regulated accounting was determined consistent with the core concepts of Public Sector Accounting Standards.

While the financial statements of the IESO and OPG have been released, reflecting the impact of the Fair Hydro Plan on their organizations for 2017, the Province has not released its consolidated financial statements.

The Province has released its 2018 Budget and 2018 Pre-Election Report, both of which focus primarily on the projected surplus/(deficit) of the province in future years. Therefore the difference between the Province's accounting for the Global Adjustment Refinancing and that of the Auditor General is based on the Province's accounting as determined by OPCD and the special report issued by the Auditor General.

Considerations:

Changes in the accounting currently used by the Province will require legislative, regulatory or policy changes.

For the accounting for the market accounts,

- The IESO is currently classified as an Other Government Organization under PSAS. The government could review this classification and/or make legislative changes which would alter its classification to that of a Government Business Entity or a Trust Under Administration. The results of this change would be to consolidate the IESO on a one-line basis (like Hydro One and Ontario Power Generation) as a GBE or not consolidate it (but solely disclose in the notes to the financial statements) as a Trust Under Administration.

Pros

- Opportunity to align the financial presentation of the IESO to what the Province wants it to operate as
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Cons

- Supporting rationale for the change would be subject to scrutiny
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- As a practice, we rely on the opinion of the external auditors of the consolidated entities to confirm the balances we are consolidating. In this case, the OPCD could establish a Provincial accounting policy with respect to market accounts and adjust the statements to remove the market accounts from the consolidated balances and include a note disclosure to the consolidated financial statements

Pros

- PSAS requires adjustments for differences in accounting policies for consolidated entities; currently done in other circumstances (e.g. hospital capital projects under AFP model)
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Cons

- Creates discrepancies between the audited financial statement presented in Volume 2 and the consolidated financial statements
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For the Fair Hydro Plan accounting, there are several options:

- The government can pass a regulation to direct an accounting interpretation of PSAS to be used by the Independent Electricity System Operator (IESO) which prohibits the use of rate-

regulated accounting. This would result in the IESO reporting the expense related to the shortfall which would be consolidated to the Province's expense.

Pros	Cons
• Not a precedent; have issued regulations to clarify interpretation of PSAS in the past (e.g. school board accounting for capital contributions) •	• AG is not supportive of the use of regulation to define accounting which, in her opinion, deviates from PSAS •
• The government can amend the <i>Ontario Fair Hydro Plan Act</i> to remove the recovery from ratepayers through the Clean Energy Adjustment; this would remove the necessary circumstances related to recovery from ratepayers needed to recognize a rate-regulated asset under US GAAP and thus require it to be expensed by the IESO.	

Pros	Cons
• Clearly establishes the tax base as the source for repayment; no longer a rate-regulated asset under accounting guidance •	• Deviates from established practice for energy investments being recovered from the ratepayer •
• The government can amend the terms of the trust agreements with the Financial Services Manager of the Fair Hydro Plan Trust (currently OPG) to bring the Fair Hydro Plan Trust under the direct control of the Province requiring it to be consolidated as a government organization. Intangible assets are not permitted under PSAS so any such balances reported by the Fair Hydro Plan Trust would be adjusted to expense upon consolidation under PSAS.	

Pros	Cons
• Brings decision-making back to MOF on terms of debt issuance (currently with OPG) • Provides option for government to direct borrow and lower interest cost	• Challenges the need for the FHP Trust; decision on whether to wind-up or not •

Delivery/Timelines:

Legislative and/or policy changes invoked prior to the release of the 2018 Public Accounts and specifically applicable would be reflected in the consolidated financial statements. The Public Accounts is required to be released within 180 days after the fiscal year end (March 31).

Other Jurisdictions:

For both of these issues, factual circumstances are unique to Ontario and jurisdictional comparison may not be fully reflective of options available to the government.

Other Considerations:

The government may wish to create an Audit Committee composed of senior officials and the Auditor General to discuss emerging accounting issues and their impact on the Public Accounts. The purpose of this non-binding committee would be to bring forward items identified through the Public Accounts (and throughout the year) for a broader discussion of objectives and clarification in the government's reporting.

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