Briefing Note

Office of the Treasury Board
Office of the Provincial Controller Division
Program Expenditure Management Division

Debt Financing the Global Adjustment: Preliminary Accounting and Fiscal Analysis

Issue:

The Ministry of Energy is exploring an electricity rate mitigation option in which the billing impact of the Global Adjustment (GA) on ratepayers would be reprofiled to be lower in the immediate term and spread out over a longer timeframe. The incremental cost of the initiative associated with debt financing would be borne through future rates.

Commented [np1]: So not by the taxpayer? Could be a rate regulated asset then?

Current Status:

The Ministry of Energy has requested comments from the Ministry of Finance and Treasury Board Secretariat.

Background:

The Ministry is implementing a series of electricity price mitigation initiatives, such as the Ontario Rebate for Electricity Consumers (OREC provides a rebate of 8% of electricity bills) that launched January 1, 2017. OREC is currently funded from taxpayers. The Ministry is also developing further electricity rate mitigation initiatives, including rate relief for industrial and commercial consumers, Direction has been provided that the 2016 Budget commitment that industry will not face an increase in electricity prices due to cap-and-trade will not be funded from cap-and-trade proceeds. The Ministry has included initiatives that would be funded from the Trillium Trust. In addition, MOECC's Ontario Climate Change Solutions Deployment Corporation (OCCSDC)is expected to develop further programs that could provide rate relief and Ministry of Energy has suggested that include transitioning to the OCCSDC responsibility for paying for conservation and demand management programs.

Global Adjustment (GA) is comprised of several elements. A key GA charge is to electricity consumers to make up the gap between the market price of electricity and the higher, non-market prices that most electricity producers, both public and private producers, receive through contract prices. For residential customers, GA is embedded within time of use rates as a cost per kilowatt hour. For major manufacturers and large businesses, the fee appears separately on electricity bills. Our understanding if that currently the GA is fiscally neutral to the Province (excluding the amount of the payments that are received by OPG and therefore, consolidated.) The payments to the producers made by IESO are passed through to the LDCs for billing to the ratepayers.

Commented [NP2]: Bharat to confirm?

The current proposal is that debt would be issued to finance a portion of IESO's costs resulting from the timing gaps between producer/program expenses and proceeds collected from energy consumers through the GA. It is not clear which entity (the Province or IESO or some other entity) would issue the debt, and therefore whether IESO would receive proceeds, and if so, how that would be recorded. For now an assumption has been made that OFA would borrow in the market and lend the money to

Commented [np3]: Collected from LDC's?

IESO to bridge the gap between the amounts paid to the producers and the amounts collected from ratepayers as it related to the GA.

Commented [NP4]: If it is going to bridge the gap for ratepayers, then it will be reflected through adjusted billings (regulatory accounts reported by the IESO would be impacted, assuming approval from the OEB).

Energy's proposal includes scenarios that set the 2017 amount of GA paid by ratepayers at a value lower than the true cost of GA and increasing that amount year-over-year at inflation (assumed to be 2%) until the debt has been paid off.

The proposal would have impacts on the Province's consolidated debt position and Interest On Debt, in addition to any fiscal impacts that would arise through consolidation of IESO.

Commented [NP5]: Is the province expected to recover? If so, wouldn't an receivable be established?

The assumptions and numbers in the proposal would need further review, both to assess the potential impact on consumer rates and related accounting treatment, as well as the quantitative analysis to be relied upon for decision making purposes. The Ministry of Energy has outlined a number of anticipated impacts on ratepayers. It is unclear whether these could result in further pressure on the government to offset these. These include:

- Incurring debt to finance the GA, while lowering ratepayer costs in the short term, the proposal results in a more rapid rise in electricity prices in the future beyond the rate of increase already expected.
- The GA financing proposal involves accruing large amounts of debt to reduce interim electricity rates. This debt would be highly sensitive to interest rates which could extend repayment timelines or put significant pressure on rates (see Scenario 3 for an example of such interest rate risk).
- GA and HOEP provide a natural hedge against each other. Smoothing only one component would lead to greater price volatility. For example, if HOEP is higher than expected (due to higher gas or carbon prices, for example), all-in rates will rise significantly as the natural decrease in GA would not occur given the prescribed GA rate.
- Conversely, if GA is higher than forecast (i.e., because of lower HOEP or additional out-of-market costs), the debt would increase to a higher amount, requiring additional debt service payments and/or a longer recovery period.
- Should Ontario demand be lower than forecasted, the cost of paying off the debt will be shared by a smaller pool of consumption, further increasing future costs for individual ratepayers.

<u>Accounting Treatment and Risks</u>

The following analysis is based solely on the deck provided (included in Appendix A) as we have not had any conversations with the Ministry of Energy or the IESO regarding whether they have completed an accounting analysis on this issue.

The focus on the accounting treatment is based on the impact to the consolidated financial statements of the Province. IESO is a consolidated entity of the Province and follows Public Sector Accounting Standards. As such, IESO does not follow rate-regulated accounting (no such concept exists in PSAS). Therefore, based on the proposal, it is likely that the difference between the amounts paid to the producers and the amount billed and collected from the ratepayers (which would now differ), will be an expense in the period (e.g. an increase to the deficit of the Province.). In addition, the amount of interest incurred on the new debt would also be an expense of the Province (e.g. an increase to the deficit of the Province.).

PSAB does not provide guidance on forgivable revenue or temporarily forgivable revenue, but related guidance on forgivable loan under PS 3050.20, "wh*en an amount is advanced with forgivable conditions, it should be accounted for as a grant (expense) unless it meets the definition of a loan receivable and there is sufficient evidence of a reasonable expectation of its recovery"* would helpful in providing advice on our unique situation.

Commented [np6]: Is the concept of forgivable loan included in the proposal?

While it is the case that the amounts incurred related to the Global Adjustment that are not billed in the period would be billed in a future period (unclear that this is with or without interest), prior to billing, those amounts do not meet the definition of an asset. The amounts may meet the definition of a rate regulated asset, but as noted above, PSAS does not include this concept.

Commented [np7]: Not consistent with OPA's former treatment of rate regulated recoverables.

In summary, in the early years, during the period that the amounts collected from the ratepayers is lower than the amounts paid to the producers; a fiscal pressure would result from this gap in addition to the interest expense. As a result of additional loan to finance the IESO payment to the producers for difference between unbilled amount and amount charged by producers, Province's consolidated net debt is expected to increase and further impact to key net debt ratios.

Commented [np8]: Would be accounted for as an asset according to OPA's former accounting treatment

On mechanism, while the Ministry suggests that TBS staff approval is not required to take a regulation forward, it is likely that any such regulation would require the approval of Treasury Board and/or the President of Treasury Board (or potentially the Controller in exercise of her delegated authority), in order to ensure no conflict with the provisions of the FAA regarding the authority to make accounting policy and to direct accounting functions.

<u>Reporting Risks</u>

The Ministry is proposing two initiatives that would affect the Trillium Trust.

The Ministry proposes that the Trillium Trust be used to fund \$1.6B over 5 years of investments in energy infrastructure, such as transmission upgrades or natural gas expansion. Key risks are:

- While the Trillium Trust is dedicated to funding for physical infrastructure, which would include energy infrastructure, it would need to be determined whether all of Energy's proposed spend would qualify. (It is assumed in this note that Energy has correctly represented the fiscal impact profile of the capital spend)
- Any recovery from Trillium Trust must have a matching expense on the CRF – it would need to be confirmed with Energy whether that is the expectation for their proposed programs.
- The Ministry is suggesting the Trillium Trust could be refreshed through cost-recovery from industry, achieved through transmission rates over time as industry benefits. This would require demonstrating either a payment to the CRF or a fiscal benefit in those amounts.
- Replacement funding for Moving Ontario Forward would need to be identified, as well as any impacts on the fiscal plan.

The Ministry is also proposing that the \$2.6B Departure Tax be dedicated for electricity price mitigation initiatives. Key risks are:

- The Departure Tax is already reflected as a non-cash benefit in the Trillium Trust. The Departure Tax contribution amounts to over half of the balance currently reflected in the Trust.
- Adds significantly to the pressure on the fiscal strategy, and the need to identify replacement funding for Moving Ontario Forward.

Any major adjustment to the Trillium Trust should be verified with the Auditor General as to whether it is seen to continue to respect PSAB standards.

The Ministry is proposing regulation that allows IESO to recover GA conservation costs from the rate payers. The ministry did discuss not how the other two components (1) regulated and (2) contracted generation would be addressed in the proposed GA financing initiative.

OFA explained that the major component is in GA financing is contacted generation and provided an example of 50 years life of generation station electricity to be used for 100 years to be recover from rate payers and this would be treated an accounting error and would create fiscal hit.

Commented [np9]: Wouldn't it just be a change in accounting estimate and accounted for on a prospective basis (based on new info)

The deck suggests that Energy is in consultation with IESO and its auditor to provide opinion on accounting of proposed GA initiative.

The IESO is classified as OGO and Province consolidate it on line by line basis using PSAS. The AG will expect to remove all RRA upon IESO consolidation to the Province CFS.

Commented [np10]: Not if one considers OPA's former accounting analysis which allowed for such assets to be accounted for on OPA's PSAS based books.

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