Ontario

FACT SHEET

Ministry of Energy

Auditor General's Special Report on the Ontario Fair Hydro Plan

October XX, XXXX

The special report from the Office of the Auditor General (OAG) focuses on the financial and accounting framework of Ontario's Fair Hydro Plan (OFHP), which is delivering the single largest reduction in electricity rates in the province's history by lowering electricity bills by an average of 25% for residential consumers, and holding increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting.

Refinancing the Global Adjustment (GA)

- To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the GA, which recovers costs associated with recent investments in the electricity system.
- Refinancing the GA provides significant and immediate rate relief by spreading the cost of electricity system investments over the expected useful life of the generation assets that have been built.
- In developing the policy to refinance the GA, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.
- The GA refinancing design effectively achieves the goals of the refinancing program and ensures that the deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

Ontario's Fair Hydro Plan Accounting

- The government's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS), and will continue to follow these standards for the transactions resulting from Ontario's Fair Hydro Plan (OFHP) in 2017-18 and in future years.
- In the development of GA refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- The Independent Electricity System Operator (IESO) will reflect the impact of the GA refinancing using rate-regulated accounting:
    - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
    - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
    - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America.

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- PSAS is silent on the use of regulated accounting:
    - PSAS acknowledges that it does not provide guidance on all possible transactions and notes that it is necessary to refer to other sources of guidance that are consistent with the PSAS framework; and
    - The IESO consulted US GAAP, which with the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the Ontario Energy Board (OEB) in accordance with the Electricity Act and the Ontario Energy Board Act.

Ontario Power Generation as Financial Services Manager

- Ontario Power Generation (OPG) has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
- OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.
- OPG currently manages approximately $20 billion in nuclear funds and as an entity regulated by the Ontario Energy Board (OEB), OPG has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
    - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.
- Further, the structure of the OFHP incents OPG, in its role as FSM, to keep the cost of borrowing to a minimum by basing a portion of its management fees on its ability to achieve lower than forecast interest rates.
- OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.

Financial Accountability Office's Report on the Costs of the Ontario's Fair Hydro Plan

- The Financial Accountability Office's (FAO) report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry refined a number of variables, including the cost of borrowing and electricity system cost forecasts.
- Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since FAO released its report in May 2017. The borrowing costs are now forecast to be substantially lower than original estimates.
- Current government estimates forecast that the peak debt over the thirty year life of OFHP will be below $20 billion. The preliminary estimate from March 2017 was about $28 billion.

Commented [AL3]: Slightly altered wording because the technical deck did not specify that IESO had consulted US GAAP

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- The FAO report concludes by saying “the FAO’s estimates are subject to many assumptions and uncertainties … Fiscal impact may differ significantly from the FAO’s estimates.”

- OPG is now beginning the process of raising funds to finance these deferred costs, and while total borrowing costs will not be known until the transaction is complete, accumulated interest is projected to be considerably less than the estimates in the report of the FAO.

- The government will also continue to identify and implement initiatives to take costs out of the electricity system, which would reduce the cost of the GA refinancing program. Further details will be released in the 2017 Long-Term Energy Plan (2017 LTEP), which will be released on October 26, 2017.