QP BRIEFING

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1). AUDITOR GENERAL REPORTS FAIR HYDRO PLAN WILL COST UNNECESSARY BILLIONS, OBFUSCATE COSTS

By: QP Briefing Staff

Ontario's Auditor General is challenging the provincial government over its plan to lower electricity bills over the next decade through a complex borrowing scheme — throwing its balanced-budgets promise into doubt less than one year before an election.

Auditor Bonnie Lysyk released a report on the Fair Hydro Plan Tuesday morning that said it will "unnecessarily cost Ontarians billions of dollars" while its complex structure serves to "obfuscate" the financial impact of the plan.

The centrepiece of the Fair Hydro Plan is a complex scheme designed to allow the borrowing of funds — somewhere in the $20 billion range, according to estimates — that will be used to allow the government to keep electricity bills artificially low over the next decade, without the debt showing on the province's books. The debt is to be paid back by ratepayers over the following two decades.

It involves a partnership with Ontario Power Generation (OPG) and the Independent Electricity System Operator (IESO) to create a regulatory / investment asset ultimately controlled by a new body, within OPG, called OPG Trust.

"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," Lysyk wrote. "In essence, the government is making up its own accounting rules."

Lysyk wrote that, according to proper accounting standards, the debt should be accounted for in the government's annual budgets, starting this year.

"The government knew there was a high risk that it would receive a 'qualified' audit opinion on the Province’s consolidated financial statements as a result of using legislation to create a regulatory asset, but it accepted this risk in order to avoid showing a deficit and an increase in net debt in its budgets and consolidated financial statements," she wrote.

"Accordingly, the 2017/18 budget does not, but should, include the impact for 16% of the costs of the Policy Decision to reduce electricity rates by 25%. The 16% reduction is estimated to cost an average of $2.5 billion per year (over 10.5 years) through to 2027."

Lysyk's report is relatively scathing for an auditor who, even in past conflicts with the government, has tended to use more measured language.

"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," she wrote.

"When organizational structures and transactions are designed to remove transparency and accountability, and unnecessarily cost Ontarians billions of dollars, the responsibility of an

Auditor General is to apprise the Legislature and the public in accordance with the Auditor General's mandate. The situation just described will come to pass if the complex accounting/financing design of the Ontario Fair Hydro Act, 2017 (Fair Hydro Act) is implemented."

Lysyk wrote that the total borrowings to be repaid by ratepayers will be an estimated $39.4 billion, with $21 billion of it accumulated interest, an estimate based on a Financial Accountability Officer (FAO) report released last spring.

Based on the FAO's estimates, Lysyk wrote that the scheme will cost Ontarians $4 billion more in interest payments than if the province had borrowed the funds directly.

"This cost stems from the fact that OPG/OPG Trust must pay a higher interest rate on borrowings than the Province would if it were to borrow in the normal manner through the Ontario Financing Authority," Lysyk wrote, adding that senior government officials were aware of that when the plan was created.

However, she also observed that the actual extra cost — the "interest rate spread between OPG/ OPG Trust debt and Provincial debt" — "will depend on market conditions at the time of the debt issuance."

The FAO had warned in its spring report that if the scheme does not meet with public sector accounting standards, the borrowed funds should count toward the province's net debt, suggesting that MPPs consult with the Auditor General on the issue.

Energy Minister Glenn Thibeault and Treasury Board President Liz Sandals responded to the Auditor General's report, saying the disagree with her conclusions, particularly the assertion that "unnecessarily" complex scheme was created as it was in order to keep the debt off the government books.

“There are no fast ones being pulled at all," Thibeault said.

The government also argues the scheme does meet public sector accounting standards and that the borrowing costs will be much lower than those cited in the report.

The government also disagreed with Lysyk's assertion that the plan was structured with the motive of avoiding budget deficits.

"Despite the report's assertion that the government's intention was to avoid recording a deficit in the fiscal plan, the decisions made to implement [the refinancing plan] most 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," the government statement says. "The accounting for this transaction will reflect the substance of this transaction."

But Lysyk cited senior government officials and staff who expressed doubts about the merits of the plan. They believed the elaborate financing scheme would result in higher costs, and that both the Canadian Public Sector Accounting Standards and the Auditor General would be unlikely to allow the financing scheme. "Hopefully [the government] will come to the conclusion that [the Fair Hydro Plan] can be financed by the province ... rather than externally, as that would be a lot simpler and cheaper" one senior official wrote in an email.

The Auditor General's conclusions were not unexpected. Last spring, she testified at the committee studying the legislation that the scheme did not meet accepted public sector reporting standards, and warned it set a dangerous precedent.

"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."

By Jessica Smith Cross and David Hains

2). Explainer: A primer on the Auditor General's scathing report on the Fair Hydro Plan

By: QP Briefing Staff

Ok, so what was the Auditor-General's report about today, and why does it matter?

Bonnie Lysyk, the Auditor General, tabled a scathing report on how the government plans to finance its Fair Hydro Plan. She argued that the government was making up its own accounting rules "that serve to obfuscate the impact of their financial decisions" and that they did so "to avoid affecting its fiscal plan" and that this financial structure could cost up to $4 billion more than necessary.

So how exactly does this financial instrument work?

It's complicated.

The first thing to understand is that there are two main parts to the Fair Hydro Plan's 25-per-cent rate reduction. There's an HST rebate that is slightly more than one-third of the overall savings, and the financing structure that accounts for slightly less than two-thirds. Lysyk doesn't have a problem with the HST rebate portion of the plan.

What is at issue is the financing for the rest of it.

Although ratepayers are now paying less money, hydro costs haven't actually gone down, because they're based on fixed contracts with electricity providers. Instead, the financing pays the gap between the discounted rate and the real price. But that money has to come from somewhere. The government, through the Independent Electricity System Operator (IESO) and the Ontario Power Generation (OPG), is effectively borrowing money backed by the future cash flow of ratepayers — basically, it's like selling future coupon payments from a bond. But this also assumes that rates will increase further in the future to offset present discounts, and pay for the interest costs.

But what about the $4 billion?!

The $4 billion is an estimate provided by the Financial Accountability Office (FAO) of Ontario, which was cited in the auditor's report. The FAO estimated the interest costs to eligible ratepayers, as a result of the borrowing to lower their electricity bills, will total about $21 billion.

The FAO estimated that would be $4 billion lower if the government were to borrow the money as it normally does.

The government, through the Ontario Financing Authority, could go to the capital markets and raise the debt to fund the hydro reduction as it normally would. Because the government borrows at lower interest rates, doing so would have been cheaper — the FAO says by up to $4 billion, but that depends on the vagaries of interest rates and other assumptions.

However, the government says it now expects it will be lower than previously thought.

Why is the government making ratepayers pay more? The government borrows money all the time for all sorts of things.

The debt from this financial instrument isn't on the government's books, and that's what the auditor-general takes issue with.

Instead, it created a confusing financial instrument that sits on the books of a newly created entity within OPG called OPG Trust, when borrowing under its own power would have added to the deficit and broken the Liberals' balanced budget promise. The government also provided capital markets with a guarantee on the debt instruments issued by OPG Trust.

Lysyk argues this was all by design, and that the policy imperative here was to lower hydro rates without affecting budget targets, despite it not being the cheapest or most common sense plan. She argued that by using OPG Trust as the debt vehicle, the government could effectively use looser U.S. accounting standards, thereby creating a slippery slope whereby the government could issue debt without representing it on its balance sheet.

The A-G is basically saying that the government is trying to have its cake and eat it too.

What is the government saying?

For starters, they say that cake is delicious.

More seriously, the government is saying that this is not about trying to hide debt at all, but it is actually being principled when it comes to accounting standards.

Energy Minister Glenn Thibeault and Treasury President Liz Sandals both argued that it was only right for this debt to live on the OPG Trust books because it's hydro debt. They appeared to hold strong convictions about these accounting principles, even though the alternative costs up to $4 billion more.

“The normal way to fund electricity system generators in the Province of Ontario, or to the best of my knowledge any other jurisdiction, where the province isn’t owning everything directly, is the electricity generator borrows on the market,” Sandals said. “Why would we change that?”

Sandals argued that when a dam is built, that lives on the hydro authority's budget too, because it's backed by ratepayers, and a policy decision was made not to mix what is paid by ratepayers and taxpayers.

When a reporter pointed out it would be $4 billion cheaper, she responded: “But if you’re going to take that logic, then we should go out and borrow for nuclear generators, we should go out and do the borrowing for hydro dams, we should go out and do the borrowing for whatever form of electricity generation is. And that is not the history of how we finance electricity generation in the Province of Ontario.”

However, it’s worth noting that the debt isn’t being used to purchase an electricity generating asset; it is being used to finance temporary electricity bill reductions.

And what's the opposition saying?

They're saying the cake is a lie.

NDP MPP Peter Tabuns argued the government should have raised its own debt rather than paying premiums to have it done through the OPG Trust, and that it's another reason to throw the Liberals out of office.

PC Energy Critic Todd Smith argued it was another reason to distrust the Liberals. However, when asked in a media scrum whether the PCs have a hydro plan, he said yes, but did not give details on what they would do instead.

Neither Tabuns nor Smith would say what their respective parties would do about all of this if they are elected — neither would commit to dismantling OPG Trust or discontinuing the government's borrowing plan.

Has this been done in the past?

The Auditor General said the government's borrowing scheme is unprecedented, as is its approach to the accounting.

However, Sandals said the accounting the government is relying on is nothing new — it is a U.S. standard that is the norm within the electricity sector in Ontario — to which Lysyk's response is, the government is not a utility.

"The application of U.S. accounting does not apply at the government level and the government is not a utility," she said. "What we're wrestling with now, this planned accounting, is a first in Canada."

However, the Lysyk offered a historical example of when the government of Ontario has dealt with electricity costs that stem from a policy decision, but have not yet been billed to ratepayers. She looked to the $19.4 billion stranded debt left by the breakup of Ontario Hydro in the late 1990s.

She wrote that in the 1999-2000 fiscal year, the government included the debt in its consolidated financial statements, following the proper accounting standards.

"When the debt retirement charge was added to electricity bills, the charge to ratepayers was taken in as revenue in the Province's consolidated financial statements," she wrote. "This treatment allowed the government to track ratepayer costs and taxpayer costs separately, helping to ensure that only ratepayers, not taxpayers, pay for electricity services."

What about the emails?

The Auditor General said she requested a review of documentation on the issue, including government emails, when it became clear to her in May that the province was not going to be forthcoming with her about all of the details of the plan.

In her report, Lysyk wrote that her office received all information it requested from all of the organizations involved, except for the Ministry of Energy, which signed a contract with a law firm — with a retainer of $500,000 — for assistance with compiling emails in response to her request. However, that has not yet been completed.

Thibeault said Lysyk's request covered a broad subject matter, which produced "over a hundred and some thousand" emails, and so the law firm is making sure all of the emails relate specifically to the issue at hand. So far, the ministry has produced about 7,000 emails and will continue to disclose more, he said.

Some of the emails disclosed some of what government officials thought about the plan, including one who wrote that he or she hoped the government would use its own borrowing power, rather than the OPG's — as Lysyk has suggested.

"Hopefully they'll come to the conclusion that it can be financed by the province ... rather than externally, as that would be a lot simpler and cheaper," the official wrote, according to the auditor's report.

The emails also indicated that senior officials were well aware that Lysyk would have a problem with the plan, she said.

"It appeared we were viewed as a risk, a risk that we might speak out against this, a risk that this could affect their financial position," Lysyk said. "I think the risk has been realized."

3). In Brief: High tech, high heels, and high tensions over NAFTA

By: Christopher Reynolds

Step up your game, Amazon.

Google's urban-oriented sister company Sidewalk Labs has struck a deal with Toronto to become the anchor to Quayside, aiming to morph the windblown east waterfront into a high-tech "internet city," officials announced Tuesday.

To construct the Quayside neighbourhood, Sidewalk — the city-building branch of Google's parent company Alphabet — has committed $50 million so far in a partnership with the city. Toronto is also pursuing online retail giant Amazon in a bid to have it put down roots with a second headquarters in the area.

Quayside will also become the seat of Google's new Canadian headquarters and a rough template for the adjacent Port Lands, "the largest undeveloped piece of urban real estate in North America," Mayor John Tory said. The five-hectare site near Queens Quay East and Parliament Street will serve as a kind of pilot project for about 300 more hectares, which Sidewalk envisions as a cutting-edge home to self-driving cars, "adaptable buildings" and green, tech-studded development, all friendly to families, offices and cultural hubs.

Premier Kathleen Wynne, standing near Prime Minister Justin Trudeau and Alphabet chairman Eric Schmidt on Tuesday afternoon, said that "nobody involved in this project wants to just build another tech park," but rather "a complete urban community."

Sidewalk and the board of Waterfront Toronto, the tri-partite agency overseeing the Quayside development, said they will kick off a year-long consultation process with a town hall on Nov. 1.

The Liberal government's bill to ban protests around abortion clinics passed second reading Tuesday.

Bill 163 found favour among members of all parties, passing in a vote of 85-1. The lone voice of opposition came from Jack Maclaren, the legislature's sole independent MPP.

The bill, which creates 50-metre buffer zones around clinics and pharmacies to prevent demonstrators from harassing patients and passersby, will move along a fast-tracked timeline, with a final vote expected next week, Attorney General Yasir Naqvi said.

The government has faced criticism from the opposition and members of the media for producing the legislation in a way engineered to expose socially conservative sympathies across the aisle, a potential trap deftly avoided by the Tories, who supported even faster passage of the bill earlier this month.

In the wake of a U.S. proposal during NAFTA negotiations to dismantle supply management in Canadian agriculture, the premier sought to reassure dairy and poultry farmers of her faith in the long-standing subsidization scheme.

"Ontario stands in agreement with Canada that negotiating supply management is simply a non-starter," Wynne said in a release Tuesday. "We will continue to work with the federal government in the fight to make sure the supply management system stays in place."

Ontario boasts the highest number of dairy heifers of any province — close to 40 per cent of the nearly 450,000 roaming Canadian farms — giving the province all the more reason for concern.

Nearly 50 new community projects are aiming to break the cycle of poverty, shore up food security and find good jobs to reduce homelessness, the province said.

Kicking off the announcement, Housing Minister Peter Milczyn, responsible for Ontario's poverty reduction strategy, rolled out a program in Hamilton on Tuesday to help single-parent families and new Canadians via home food deliveries on weekends, when school nutrition programs aren't available.

The province plans to spend $16 million on 48 community projects, cash drawn from province's local poverty reduction fund.

A bill to stomp out mandatory wearing of high heels in the workplace passed first reading Tuesday.

Liberal backbencher Cristina Martins is behind Bill 168. The Putting Your Best Foot Forward Act follows legislation earlier this year in British Columbia where heels can no longer be a mandatory part of any uniform for health and safety reasons.