WORKING DRAFT – GOVERNMENT RESPONSE TO AGO REPORT ON THE FAIR HYDRO PLAN

The government of Ontario does not agree with the assertions and conclusions expressed by the Office of the Auditor General (OAG) in its report entitled *The Fair Hydro Plan: Concerns About Fiscal transparency, Accountability and Value For Money*.

Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the province's history. In the development of OFHP, which includes a rebate equal to the provincial portion of the Harmonized Sales Tax, shifting the funding of specified electricity support programs to provincial revenues and refinancing a portion of the Global Adjustment (GA), the government considered a range of implementation options. The government consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure appropriate due diligence was completed. OFHP operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

The government has been making important investments in a cleaner and more reliable energy system, but these investments have led to higher electricity bills. OFHP has introduced new measures to lower electricity bills by 25 per cent on average for residential consumers and will hold increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting from a reduction.

Since 2003, nearly $70 billion has been invested in the electricity system, including more than $37 billion in electricity generation to ensure the system is clean and reliable. The majority of the province's electricity generators operate under 20-year contracts. Despite the OAG's assertion that it is "not at all" certain if these generating assets will be operating beyond their contract lives, third-party experts have confirmed that many of these generators will be able to continue to operate. This means that generating assets are expected to have ongoing useful life and benefit future ratepayers by reducing the need to finance the development of new generating assets. .

To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the GA, which pays for the majority of the recent investments in the electricity system. Refinancing the GA provides significant and immediate rate relief by matching the cost of electricity investments with the expected useful life of the generation that has been built. Despite the OAG's assertion that the government's intention was to avoid recording a deficit in the fiscal plan, the decisions made to implement GA refinancing 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 accounting for this transaction will reflect the substance of this transaction.

With respect to the Province's financial statements, they are prepared in accordance with Canadian PSAS and will follow PSAS in accounting for the transactions resulting from OFHP in 2017-18 as well as in the following years. As PSAS is set by an independent standard setting body in Canada focused specifically on the public sector and PSAS is used by all senior governments in Canada, presenting its financial statements in accordance with PSAS results in transparent financial reporting for the Province of Ontario.

The government of Ontario also disagrees with two fundamental accounting assertions in the report of OAG related to *legislated accounting* and *rate-regulated accounting*:

- Legislated Accounting – The *Ontario Fair Hydro Plan Act, 2017* and its related regulations <u>do not</u> "create accounting rules" or "legislate the accounting". This is a fundamental disagreement with the report of the OAG. As previously noted, the Province will prepare its consolidated financial statements in accordance with PSAS.

- Rate-Regulated Accounting – In commenting on the use of rate-regulated accounting and the role of the Ontario Energy Board (OEB), the report of the OAG makes reference to a requirement under U.S. accounting standards in connection with the use of rate-regulated accounting that "there must be an independent regulator". This reference is misleading as it does not provide the criteria in its entirety, which is as follows:

  The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator ***or by its own governing board empowered by statute or contract to establish rates that bind customers*** *[ASC 980-10-15-2].*

The U.S. accounting standard was developed specifically not to preclude the application of rate-regulated accounting by government utilities where the rate regulator would not necessarily be viewed as independent [FAS 71, par. 64]. In addition, the position that rate-regulated accounting is precluded because the OEB is not considered independent of the government of Ontario is contradictory to accepting the use of rate-regulated accounting by Ontario Power Generation (OPG) and Hydro One, both regulated by the OEB and whose results, using rate-regulated accounting, are and have been included in the consolidated financial statements of the Province.

As previously noted, OFHP is comprised of a series of policy decisions, some of which will be borne by taxpayers and some of which will be borne by ratepayers. The accounting, the final analysis and documentation of which will be completed by the year-end, once the transaction is complete, will reflect the economic substance of the transactions in accordance with PSAS and will differentiate those costs of OFHP borne by taxpayers vs. those borne by ratepayers. The OAG suggests that all of the costs of OFHP should be reflected as if they will all be borne by taxpayers, which is inaccurate.

OPG is 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 Financial Accountability Office (FAO), cited by the OAG. Total borrowing estimates over the thirty year life of the program have been revised down substantially by the government since FAO released its report in May 2017 and OPG's and its financing entity's borrowing costs are now forecast to be substantially lower than original estimates. As a result, current government estimates forecast that the peak debt over the 30-year life of OFHP will be below $20 billion. The preliminary estimate from March 2017 was about $28 billion.

Based on the comments highlighted above and given that implementation of OFHP is still ongoing with significant accounting and financing decisions still being finalized, the government believes that this report by the OAG is premature and does not reflect the substance of this transaction.