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

The government believes that this report is premature given that implementation of Ontario's Fair Hydro Plan (OFHP) is still ongoing with significant accounting, economic modelling and financing decisions still being finalized. In the development of OFHP, the government considered a range of policy options. Preliminary options, highlighted in the Office of the Auditor General's (OAG) report, should not be interpreted as "signifying" a specific intent on the part of the government to pursue those options, namely the incorrect assertions by the OAG that government specifically sought out a complex financial transaction simply to avoid fiscal consolidation. In addition, the government disagrees with the OAG's assertion that it legislated accounting and the OAG's reference to rate-regulated accounting is misleading.

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 assertion, many of these generators will be able to operate past their contract term, meaning 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. On behalf of the Ministry of Energy, in support of OFHP development and implementation, Navigant Consulting, Inc. was retained to prepare an expert report, which confirms that many generators will be able to operate past their contract term.

To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the Global Adjustment (GA), which pay 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 assertion, the accounting and financial framework used 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.

With respect to the Province's financial statements, they are prepared in accordance with Canadian Public Sector Accounting Standards (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 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 do not "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.***

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. 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 are regulated by the OEB and whose results, using rate-regulated accounting, are and have been included in the consolidated financial statements of the Province.

The OAG states that the Province's planned accounting inappropriately transfers long-term accountability for higher electricity bills to future governments. The accounting, which will be determined once the transaction is complete, will reflect the economic substance of the transaction in accordance with PSAS. In addition, the policy decision regarding the allocation of the cost of OFHP to the ratepayers and to the taxpayers is a decision of the current government. The accounting is expected to reflect that allocation decision. A decision of a future government to, for example, move the cost of all of OFHP to the taxpayer, is a decision with economic consequences and, therefore, accounting recognition. The report of the OAG suggests that such a decision has no consequences or fiscal impact.

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 for the program have been revised down substantially by government since FAO released its report in May 2017 and OPG's and its financing entity's borrowing costs are now forecast to be lower than original estimates. As a result, final government figures show that the peak debt under OFHP will be below $20 billion. The preliminary estimate was about $28 billion.

Ontario's Fair Hydro Plan is delivering the single-largest reduction in electricity rates in the province's history. The plan operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with PSAS and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.