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

The government of Ontario does not agree with the assertions and recommendations 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*.

The government has been making important investments in a cleaner and more reliable energy system, but these investments have led to higher electricity bills. Ontario's Fair Hydro Plan (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 the reduction.

Since 2003, Ontario has invested nearly $50 billion in the electricity system, including more than $35 billion in electricity generation to ensure the system is clean and reliable. The costs of these investments are funded in part through the Global Adjustment (GA). 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 will 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. 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 financial and accounting 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.

Ontario Power Generation (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 estimated in the report of the OAG. Total borrowing estimates for the program has been revised down substantially by government since the Financial Accountability Office (FAO) released its report in May 2017 and OPG's borrowing costs are now forecast to be lower than original estimates.

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 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 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 another government organization of the Ontario government is contradictory to accepting the use of rate-regulated accounting by OPG and Hydro One, both are regulated by the OEB and whose results are and have been included in the consolidated financial statements of the Province of Ontario, using rate-regulated accounting.

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.

In closing, 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 ensures that the fairness goals are achieved in a cost-effective manner.