

Q&As – OAG’s Special Report on Ontario’s Fair Hydro Plan

Q. Why did the government introduce Ontario Fair Hydro Plan?

The government has been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher bills. Since 2003, nearly \$70 billion¹ has been invested in the electricity system, including more than \$37² billion in electricity generation to ensure the system is clean and reliable.

Ontario Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the province’s history. 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.

In developing the policy to refinance the Global Adjustment (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.

GA refinancing is designed so that deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

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.

Q. The Auditor General and the Financial Accountability Office both suggest that the cost of borrowing will be more expensive than traditional government borrowing? Is this true?

In the development of Ontario’s Fair Hydro Plan (OFHP), the government made the policy decision that deferred electricity system costs should be borne by the rate-base and not the tax-base.

Based on this policy decision, it was decided that the debt obligation would be recognized as a regulatory asset that would be sold and securitized. This design appropriately aligns the costs and benefits within the group of eligible consumers.

Ontario Power Generation (OPG) was identified as the Financial Services Manager responsible for the financing plans and the financing entity (i.e., Fair Hydro Plan Trust) that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA) and will ensure that it is done in an efficient and cost-effective manner.

OPG has a demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization program and highly successful project debt issuances tied to new hydroelectric developments. The innovative, cost saving and precedent setting aspects of these structures have resulted in international recognition.

¹ Ministry of Energy, *2017 Long-Term Energy Plan*

² Ministry of Energy, *2017 Long-Term Energy Plan*

With respect to the \$4 billion³ figure referenced by the Financial Accountability Office (FAO) in its May 2017 report, it should be noted that the FAO's report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy 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 the FAO released its report in May 2017, and 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 billion⁴. The preliminary estimate from March 2017 was about \$28 billion⁵.

A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions. The total estimated cost of the program has already been revised downwards substantially to reflect revised inputs.

The government will 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.

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about \$27.7 billion⁶ to \$18.5 billion⁷. The higher March 2017 estimate was used by the FAO in its May 2017 report.

If pressed on interest costs:

The government estimates of total interest cost also decreased from \$25 billion⁸ to \$18 billion⁹.

Q. Have the Ministry of Energy's estimate for "peak debt" related to Ontario's Fair Hydro Plan (OFHP) changed? I understand that the Office of the Audit General (OAG) has asked what are the factors that resulted in the changes in estimates from March 1 to August 31?

With respect to the \$4 billion¹⁰ figure referenced by the Financial Accountability Office (FAO) in its May 2017, it should be noted that the FAO's report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy 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 the FAO released its report in May 2017, and borrowing costs are now forecast to be substantially lower than original estimates. Current government estimates forecast that the peak

³ Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*

⁴ Ministry of Energy

⁵ Ministry of Energy, submission to Financial Accountability Officer

⁶ Ministry of Energy

⁷ Ministry of Energy

⁸ Ministry of Energy

⁹ Ministry of Energy

¹⁰ Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*

debt over the thirty year life of OFHP will be below \$20 billion¹¹. The preliminary estimate from March 2017 was about \$28 billion¹².

The revised estimates are the result of the following factors:

- The Independent Electricity System Operator (IESO) updated its long-term cost projections for the electricity system and residential bills;
- The Ontario Energy Board (OEB) provided “actual data” with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
- Based on expert third-party advice the interest rate assumptions for OFHP were updated (i.e., from 5%¹³ down to 4.5%¹⁴).

In addition, for the August 31, 2017 estimate, the Ministry of Energy converted debt and interest amounts from calendar year to Regulated Price Plan (RPP) periods.

A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions. The total estimated cost of the program has already been revised downwards substantially to reflect revised inputs.

The government will 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.

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If pressed on interest costs:

The government estimates of total interest cost also decreased from \$25 billion¹⁷ to \$18 billion¹⁸.

Q. In the development of Ontario’s Fair Hydro Plan, did the government set up the financing structure intentionally to keep it off government books?

No. Global Adjustment (GA) refinancing is designed so that deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

¹¹ Ministry of Energy

¹² Ministry of Energy, submission to Financial Accountability Officer

¹³ Ministry of Energy

¹⁴ Navigant Consulting, *Assessment of the Alignment of the Costs and Benefits of Clean Energy Assets*

¹⁵ Ministry of Energy

¹⁶ Ministry of Energy

¹⁷ Ministry of Energy

¹⁸ Ministry of Energy

GA refinancing 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.

Q. Why is the government using Ontario Power Generation (OPG) as a borrowing agent for Ontario's Fair Hydro Act? Would it be easier to use a traditional government borrowing agent like the Ontario Financing Authority (OFA)?

Ontario Power Generation (OPG) has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA).

OPG currently manages approximately \$20 billion¹⁹ in segregated nuclear funds to manage nuclear liabilities, and, is an electricity sector entity regulated by the Ontario Energy Board (OEB) with extensive experience with regulatory deferral and variance accounts.

OPG also has the breadth and demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization program and highly successful project debt issuances tied to new hydroelectric developments. These financing initiatives have been well received by investors at a reasonable cost to OPG. The innovative, cost saving and precedent setting aspects of these structures have resulted in international recognition.

OPG has developed solid investor relationships and has a large investor base in the structured finance space that would be the target market for financing Ontario's Fair Hydro Plan initiative. For example, Lower Mattagami project financing attracted a broad investor base of ~80 institutional investors²⁰, including major investors in the Canadian power and utility bonds market.

In terms of administration, OPG is currently managing its own Corporate public debt program and three project financing programs totalling more than \$2 billion²¹ and two commercial paper programs.

Finally, OPG's Treasury functions are well positioned given their management of existing multiple debt programs.

Q. The Financial Accountability Office (FAO) suggested that using Ontario Power Generation as the borrowing agent will cost \$4 billion more?

The \$4 billion figure was an estimate made by the Financial Accountability Office (FAO) based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

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¹⁹ Ontario Financing Authority

²⁰ Ontario Power Generation

²¹ Ontario Power Generation

²² Ministry of Energy

²³ Ministry of Energy, submission to Financial Accountability Officer

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

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If pressed on interest costs:

The government estimates of total interest cost also decreased from \$25 billion²⁶ to \$18 billion²⁷.

Q. Do you disagree with the FAO on financial costs?

With respect to the \$4 billion²⁸ figure referenced by the Financial Accountability Office (FAO) in its May 2017, it should be noted that the FAO’s report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

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A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions. The total estimated cost of the program has already been revised downwards substantially to reflect revised inputs.

The government will 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.

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²⁴ Ministry of Energy

²⁵ Ministry of Energy

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²⁸ Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province’s Fair Hydro Plan*

²⁹ Ministry of Energy

³⁰ Ministry of Energy, submission to Financial Accountability Officer

³¹ Ministry of Energy

³² Ministry of Energy

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Q. The OAG's report claims that consumers will pay an additional \$4 billion in interest costs over the life of OFHP since OPG and its Financing Entity will pay a higher rate of interest compared to the Province. Why not have the Province borrow for the OFHP?

The policy objective of OFHP is to more fairly allocate the cost to ratepayers over the useful life, not the contractual term, of the electricity generating assets. Therefore, it was a primary policy objective to ensure that the costs are borne by the beneficiaries of the electricity system – the ratepayers – not the tax-base.

We believe it is appropriate for ratepayers to pay for the financing of electricity assets. The rate-base has a different risk profile than the tax-base, which would be reflected in different interest costs. Having the rate-base pay is not a new policy, for example Hydro One has borrowed in the capital markets since the early 2000s³⁵.

The \$4 billion³⁶ figure in the Office of the Auditor General's report was sourced from the FAO's May 2017 report and is important to note, that the FAO's calculation was based on preliminary estimates of the program when peak debt estimates for the thirty year program were substantially higher and interest costs were forecast to be higher than current projections.

Q. Why did the IESO change its accounting practices?

The Independent Electricity System Operator (IESO) began recognizing its market accounts' assets (i.e., amounts due from power distributors) and liabilities (i.e., amounts due to power producers) in their financial results.

This accounting change was accepted by IESO's independent external auditor, which issued an unqualified, or "clean," audit opinion. These accounting changes were highlighted in IESO's 2016 annual report, which was published online in March 2017.

The IESO has chosen to recognize these markets accounts on its books for transparency reasons, as it better reflects its net financial position on behalf of IESO-administered markets at year-end.

Further, this accounting is consistent with the presentation used previously by the Ontario Power Authority (which was merged with IESO on January 1, 2015) in its financial statements.

Additionally this accounting change has been supported by the professional accounting staff of the Office of the Provincial Controller.

This change has no impact to the province's annual deficit, net debt, accumulated deficit or on the ratepayers of Ontario.

³³ Ministry of Energy

³⁴ Ministry of Energy

³⁵ Ministry of Finance

³⁶ Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*

We will continue to work with the Auditor General to build on the government's track record of responsible fiscal management and high quality financial reporting.

Q. Why did the government not use the Canadian Public Sector Accounting Standards (PSAS)? How was Ontario's Fair Hydro Plan (OFHP) financing structure determined?

The Province's financial statements 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. Presenting its financial statements in accordance with PSAS results in transparent financial reporting for the Province of Ontario.

PSAS is, however, silent on the recognition, measurement, presentation or disclosure of rate-regulated activities. In absence of a clear position on an issue, standard accounting practice dictates that an entity should consult other accounting standards. In this case, the Independent Electricity System Operator (IESO) consulted US GAAP, the accounting framework in North America that provides the most developed guidance on rate regulated operations.

This financing structure is similar to several jurisdictions in the U.S., and uses a form of securitization that is commonly used in the financial markets. It ensures the impact of the plan will be transparent. Under this system, credit rating agencies, securities regulators and the public at large get full information and full reporting of the impacts of the OFHP that are visible and specific.

Q. What is the Global Adjustment (GA)?

The Global Adjustment (GA) is a mechanism that recovers certain electricity system costs, such as capital costs incurred by generators. The GA is calculated by the Independent Electricity System Operator (IESO) based on the difference between the market price for electricity, which represents the marginal cost of electricity production, and rates paid to regulated and contracted generators to ensure they can recover their fixed costs. It also accounts for costs associated with running conservation programs in the province.

GA has been an important factor in providing stable prices while ensuring that sufficient generating capacity is in place to deliver a reliable supply of electricity.

GA pays for the bulk of the recent investments in the electricity system. The majority of the province's electricity generators operate under 20-year contracts. Third-party experts have confirmed that many of these generators will be able to continue to operate beyond the end of their contract. 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.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Q. Some say you are unfairly placing the burden of debt on future generations through things like Ontario's Fair Hydro Plan, how do you respond?

Future generations will be paying their fair share for a system they will be benefiting from in their lifetime. Not only will they benefit from a reliable electricity system, but from the cleaner air from the reduction of coal-fired generation.

Ontario's Fair Hydro Plan (OFHP) acts much like taking out a new mortgage – providing much-needed relief now by spreading costs across the life of our assets. Current ratepayers are paying less now, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Moving forward, Ontario is developing its 2017 Long-Term Energy Plan (2017 LTEP) which will focus on continuing to put downward pressure on electricity bills over the long term. Our robust electricity supply puts us in a good position to improve efficiency, increase transparency and enhance opportunities for innovation and competition to further reduce system costs. That is why Ontario's Fair Hydro Plan includes a commitment to improving sector efficiency and modernizing Ontario's electricity market, building on the collaboration of the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

For example, IESO's Market Renewal initiative will result in a more efficient marketplace with competitive and transparent mechanisms that meet future system needs at the lowest cost. The initiative is expected to save up to \$5.2 billion³⁷ over a 10-year period and forms a key component of Ontario's plan to ensure the affordability of electricity in the longer term.

Q. Who was involved in the policy and implementation process to meet the mandate?

Senior officials and staff from several departments and agencies, led by the Ministry of Energy, collaborated to plan a structure, identify risks, make decisions and take other actions to meet the mandate.

The senior officials and staff were from:

- Ministry of Energy;
- Ministry of Finance;
- Treasury Board Secretariat;
- Office of the Provincial Controller;
- Cabinet Office;
- Ontario Financing Authority (OFA);
- Independent Electricity System Operator (IESO); and
- Ontario Power Generation Inc. (OPG).

In development and implementation of Global Adjustment (GA) refinancing, 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.

Document Search

Q. Why has the Ministry of Energy not provided all e-mails requested by the Auditor General?

As of October 13, 2017, the Ministry has provided 13,212 emails and attachments to the OAG's office.

³⁷ Independent Electricity System Operator, *Assessment of the Benefits of Market Renewal (Brattle Group)*

Q. How much money did the Ministry spend on lawyers?

The Ministry does not intend to spend more than \$60,000 on this request. Although the retainer agreement includes a cap of up to \$500,000, as of September 21, 2017, only \$41,775.75 has actually been spent.

Q. What was the Ministry of Energy's process for providing the emails requested by the Auditor General?

The Ministry conducted a search consistent with the 40 plus search terms provided to the AG. In order to manage the approximately 2.2 million records resulted from the search of 81 custodians, the Ministry of Energy has selected McCarthys/Wortzmans to assist with processing and analysis of the documents. No legal advice on relevancy of documents was provided by Wortzmans. The Ministry has been regularly providing AG batches of responsive documents.

This request remains a priority for the Ministry of Energy and we will continue to make effort to deliver all responsive records to the Auditor General as soon as possible. There is currently a team of 12 Ministry staff reviewing for responsive records.

Response Prepared Based on Ministers' Speaking Points

Q. How do you respond to the Auditor General's claim that the government ignored warnings regarding a potential adverse audit opinion of Ontario's public accounts?

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 regards to rate-regulated accounting, PSAS are 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
- US GAAP, with the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference.

Many entities in Canada, including OPG and Hydro One use rate-regulated accounting:

- The OAG can refer to the CPA Canada research study that was shared.
- Rate-regulated accounting is well understood in the electricity sector.
- The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America, including AESO, ISO New England, NYISO, MISO, PJM and ERCOT.

The IESO management, IESO's Audit Committee, IESO's Board of Directors, IESO's external auditor and the Office of the Provincial Controller all support the use of rate-regulated accounting by IESO.

In the development of OFHP, the government consulted with several third party advisors in the application of accounting standards. This is normal course of business governments take for complex transactions.

TBS's Detailed QAs re Ontario's Fair Hydro Plan

Q. The Auditor General says that the accounting structure for Ontario's Fair Hydro Plan is not transparent, has poor value for money, and is not in accordance with Public Sector Accounting Standards. How do you respond?

The government has the utmost respect for all independent officers of the legislature, and values the important perspective they bring.

The Ministry of Energy, the Ministry of Finance, and the Treasury Board Secretariat remain committed to assisting the Office of the Auditor General so that it can provide its independent views to the Legislative Assembly.

With regards to the Auditor General's report on Ontario's Fair Hydro Plan (OFHP) – while the government does not agree with the assertions and conclusions expressed in the report, the government thanks the Office of the Auditor General for its report.

OFHP is delivering the single-largest reduction in electricity rates in the Province's history. In developing OFHP, 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.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

The implementation of OFHP is ongoing, with significant decisions with accounting and financial implications still being finalized.

The Province's financial statements are prepared in accordance with Canadian PSAS and will follow PSAS in accounting for the transactions resulting from OFHP in 2017-18, and in following years.

As PSAS is set by an independent standard-setting body in Canada focused specifically on the public sector, and because PSAS is used by all senior governments in Canada, presenting financial statements in accordance with PSAS results is transparent financial reporting for the Province of Ontario.

Ontario has a strong track record of producing high-quality financial reports on a timely basis, and will continue to move forward and present the Province's finances fairly, accurately and in accordance with PSAS.

The Ministry of Energy would welcome further questions about OFHP and the government's investments in a reliable energy system.

Q. The Auditor General makes two recommendations in her report – to record the true financial impact of Ontario's Fair Hydro Plan; and to use a financing structure that is the least costly for Ontarians. Will you adopt these recommendations?

The government does not agree with the assertions and conclusions expressed in the report.

In developing OFHP, 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.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

In order to meet the needs of users, including the legislature and the public, for accountability in government reporting and decision making, it is essential that public sector financial statements reflect the economic substance of the government's activities.

The Province's financial statements are prepared in accordance with Canadian PSAS and will follow PSAS in accounting for the transactions resulting from OFHP in 2017-18, and in following years.

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Ontario has a strong track record of producing high-quality financial reports on a timely basis, and will continue to move forward and present the Province's finances fairly, accurately and in accordance with PSAS.

The OFHP financing structure has been designed to provide electricity rate relief to current ratepayers, including by more fairly allocating costs for specified consumers, with the Global Adjustment cost amounts still ultimately borne by specified electricity ratepayers, as beneficiaries of those electricity system costs.

Ontario Power Generation (OPG) is beginning the process of raising funds to finance the deferred costs, and while total borrowing costs will not be known until the program is complete, accumulated interest is projected to be considerably less than the estimates in the May 2017 report of the Financial Accountability Office (FAO).

Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since the FAO released its report in May 2017, and 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 billion³⁸. The preliminary estimate from March 2017 was about \$28 billion³⁹.

The Province will continue to prepare its consolidated financial statements in accordance with PSAS and continue to build on a track record of responsible fiscal management.

³⁸ Ministry of Energy

³⁹ Ministry of Energy, submission to Financial Accountability Officer

Q. Both the Auditor General and the Financial Accountability Officer (FAO) have raised serious concerns about the accounting treatment of the electricity cost refinancing initiative. Why should Ontarians believe this government over two independent officers of the Legislature?

The government has the utmost respect for all independent officers of the legislature, and values the important perspective they bring.

Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the Province's history.

In developing OFHP, 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.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

The Province, as always, will prepare its consolidated financial statements in accordance with PSAS and continue to build on its track record of responsible fiscal management.

Q. The Auditor General says that you are “obfuscating” the true financial impact of Ontario’s Fair Hydro Plan through a “needlessly complex” accounting structure. How do you respond?

Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the Province's history. In developing OFHP, 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.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

OFHP is comprised of a series of policy decisions. The impact of some of these decisions will be borne by the Province (taxpayers) where appropriate, such as sales tax relief and shifting social programs to the tax base; some will be borne by ratepayers, such as spreading the investment costs and benefits across ratepayers more fairly.

While the implementation of OFHP is ongoing, with significant decisions with accounting and financial implications still being finalized, the financing plan for OFHP and its impact will be transparent. Credit rating agencies, securities regulators, and the public will see full information and full reporting of the impacts of OFHP.

Ontario has a strong track record of producing high-quality financial reports on a timely basis. Ontario will continue to move forward and present the Province's finances fairly and accurately and in accordance with PSAS.

Q. How can you justify the \$4 billion in additional interest expenses that will be borne by ratepayers because of the way the government has structured electricity cost refinancing (i.e. using Ontario Power Generation to finance 55 per cent, at a higher interest rate than the Province, instead of the Province financing the entire electricity cost financing)?

Ontario's Fair Hydro Plan (OFHP) is comprised of a series of policy decisions. The impact of some of these decisions will be borne by the Province (taxpayers) where appropriate, such as sales tax relief and shifting social programs to the tax base; some will be borne by ratepayers, such as spreading the investment costs and benefits across ratepayers more fairly.

The accounting will reflect the economic substance of the transactions in accordance with Public Sector Accounting Standards (PSAS) and will differentiate those costs of OFHP borne by taxpayers versus those borne by ratepayers.

The Auditor General's report suggests that all the costs of OFHP should be reflected as if they will be borne by taxpayers, which is inaccurate.

Ontario Power Generation (OPG) is beginning the process of raising funds to finance the deferred costs, and while total borrowing costs will not be known until the program is complete, accumulated interest is projected to be considerably less than the estimates in the May 2017 report of the Financial Accountability Officer (FAO).

Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since the FAO released its report in May 2017, and 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 billion⁴⁰. The preliminary estimate from March 2017 was about \$28 billion⁴¹.

Q. The Auditor General said that a similar move to legislate accounting to defer costs was proposed with the restructuring of the Ontario electricity sector in the late 1990s, but the Auditor General's opinion at that time was that this would represent a departure from a central tenet of generally accepted accounting principles. The government at that time heard these concerns, and made the decision to not create an asset for future anticipated ratepayer payments. Why does the government think this is ok now?

The Auditor General's report makes a comparison between Ontario's Fair Hydro Plan (OFHP) and the Ontario Electricity Financial Corporation (OEFC) stranded debt. There are, however, crucial differences between the two.

For example, the OEFC stranded debt had already been incurred when the restructuring took place.

In the case of OFHP, the difference between what will be collected and what will be paid to generators is considered to be an asset in accordance with the accounting definition, as it will generate a specific future revenue stream in the form of the CEA.

It is important to note that the 1999 restructuring led to an "unbundling" of the electricity rate. Prior to the 1999 restructuring and the 2002 market opening, there was a "bundled rate" for electricity that

⁴⁰ Ministry of Energy

⁴¹ Ministry of Energy, submission to Financial Accountability Officer

included cost recovery of generation and transmission costs, operating and capital – including debt costs, as well as central market operations costs. Including debt cost recovery and matching the timing of the capital cost recovery with the benefit to the ratepayer is a normal rate-setting regulatory practice.

The Debt Retirement Charge (DRC) represented the unbundling of a portion of the debt service costs. It effectively amortized the cost of the investments in long-lived assets (including debt incurred).

OFHP's Global Adjustment (GA) deferral is also intended to have costs recovered from specified ratepayers over a time period that better reflects the expected lives of those assets (versus the contract lengths that may be shorter than the expected useful life of the assets).

The difference between the 1999 restructuring and OFHP is that the DRC continued to pay down, over time, debt that had already been incurred, while under OFHP, an asset is being recorded to reflect a fair allocation of electricity costs between current and future ratepayers.

The intention of OFHP is to be forward-looking, to ensure that ratepayers are sharing current and future costs, whereas the DRC was backward-looking, replacing part of a bundled rate that was already spreading the cost recovery of the debt over time.

Q. What will happen if interest rates rise? The Financial Accountability Officer (FAO) estimates that if interest rates were to rise, the true cost of Ontario's Fair Hydro Plan could be between \$69 and \$93 billion. How can you justify shifting this heavy burden onto future generations?

The implementation of Ontario's Fair Hydro Plan (OFHP) is ongoing, with significant decisions with accounting and financial implications still being finalized.

Ontario Power Generation (OPG) is beginning the process of raising funds to finance the deferred costs of OFHP, and while total borrowing costs will not be known until the program is complete, accumulated interest is expected to be considerably less than the estimates cited in the May 2017 report of the FAO.

Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since the FAO released its report, and 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 billion⁴². The preliminary estimate from March 2017 was about \$28 billion⁴³.

Government Officials

Q. The Auditor General says that even your own government officials flagged the unnecessarily high costs of Ontario's Fair Hydro Plan – and yet you chose to proceed. How can you justify this?

In developing Ontario's Fair Hydro Plan (OFHP), 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.

⁴² Ministry of Energy

⁴³ Ministry of Energy, submission to Financial Accountability Officer

Multiple options were considered in creating the OFHP framework – such as to have local distribution companies finance the difference between the amounts paid to the generators and the amounts collected from the ratepayers. This was rejected because of the inability of some local distribution companies to finance the balances.

The implementation of OFHP is ongoing, with significant decisions with accounting and financial implications still being finalized.

Ultimately, OFHP operates under a financial and accounting framework that is appropriate for the intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

Audit Opinion

The government just received another qualified audit opinion on its Public Accounts – this time based on two separate issues. Why do you continue to disagree with the Auditor General?

The government continues to move forward and present the Province's finances fairly and accurately and in accordance with Canadian Public Sector Accounting Standards (PSAS). Ontario has a strong track record of producing high-quality financial reports on a timely basis. The Auditor General's qualified opinion is based on a different interpretation of PSAS for net pension assets and recognition of market accounts.

Last year there was a disagreement among the Province's professional accounting staff and the Auditor General's Office on the appropriate application of PSAS regarding pension accounting. As a result, the Pension Asset Expert Advisory Panel was established to deliver independent advice and recommendations on the issue to the Province.

The independent panel members concluded the Province's share of the net pension assets of both the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan should be recognized in Ontario's financial statements.

After significant deliberation, including consideration of the recommendations of the panel, Ontario confirmed that the accounting for these plans prior to 2015-16 was appropriate, and are prepared in accordance with public sector accounting standards for pension asset accounting. Further, EY provided additional analysis and concluded that no valuation allowance was required for either plan as of March 31, 2017. The 2016-17 financial statements include these pension assets, and we continue to apply the accounting treatment of pension assets that the Province has used consistently since 2001. In addition, the 2015-16 financial statements were restated to include these assets.

This year the Independent Electricity System Operator (IESO) began recognizing its market accounts' assets (amounts due from power distributors) and liabilities (amounts due to power producers) in its financial results. The IESO has chosen to recognize these markets accounts on its books for transparency reasons, as it better reflects the financial position of IESO-administered markets at year-end. This change was supported by IESO's audit committee, its independent external auditor, and finally by the Office of the Provincial Controller. This change also has no impact to the Province's annual deficit, net debt or accumulated deficit.

This accounting is consistent with the presentation used previously by the Ontario Power Authority (which was merged with IESO on January 1, 2015) in its financial statements, which was not subject to qualification from the Office of the Auditor General at that time.

Q. The Auditor General says that you anticipated the government would receive a qualified audit opinion – and accepted this risk. In the private sector this would be unacceptable. How do you figure you can get away with this?

The Province's financial statements are prepared in accordance with Canadian Public Sector Accounting Standards (PSAS).

As PSAS is set by an independent standard-setting body in Canada focused specifically on the public sector, and because PSAS is used by all senior governments in Canada, presenting financial statements in accordance with PSAS results in transparent financial reporting for the Province of Ontario.

PSAS are principle based -- they are not a set of specific prescriptive rules. Applying them requires the application of professional judgment.

Our professional staff exercises judgment in applying the standards and as necessary consult with external experts and advisors. They provide the Office of the Auditor General with their written analysis on all significant issues that impact the financial statements for the year being audited, and they discuss the issues with the Office of the Auditor General.

All Chartered Professional Accountants (CPAs), including those employed by the Ontario Public Service (OPS), are required to comply with the Code of Professional Conduct for CPAs. One of those rules is that they not be associated with false or misleading information.

That means that if the professional accountants in the OPS do not agree with the judgment of the Ontario Auditor General, it is not as simple as just agreeing to accept the interpretation of the Office of the Auditor General if they believe that interpretation would result in false or misleading financial statements. While we expect professional accountants to agree on the vast majority of issues, we acknowledge that they may not agree on everything and when that occurs, and the difference is material to the financial statements, the Office of the Auditor General can choose to issue a qualified audit opinion.

Q. Are you concerned that the Auditor General will issue an adverse opinion on the Province's Public Accounts due to Ontario's Fair Hydro Plan accounting? What would be the impact on the Province's credit rating?

It would be inappropriate to speculate about how the Auditor General may issue an opinion for Public Accounts next year. The implementation of Ontario's Fair Hydro Plan (OFHP) is ongoing, with significant decisions with accounting and financial implications still being finalized.

The Ministry of Energy, Finance and the Treasury Board Secretariat continue to work closely with Ontario Power Generation (OPG), the Independent Electricity System Operator (IESO) and third-party accounting, financing and energy experts to ensure due diligence.

The Province's financial statements are prepared in accordance with Canadian PSAS and will follow PSAS in accounting for the transactions resulting from OFHP in 2017-18, and in following years.

The financing plan for OFHP and its impact will be transparent. Credit rating agencies, securities regulators, and the public will see full information and full reporting of the impacts of OFHP.

Ontario has a strong track record of producing high-quality financial reports on a timely basis. Ontario will continue to move forward and present the Province's finances fairly and accurately and in accordance with PSAS.

Q. The Auditor General says that she has consulted with all of the Auditor Generals in Canada – and they agree with her assessments. How are we supposed to believe this government when all independent auditors in the country say you are wrong?

In developing Ontario's Fair Hydro Plan, 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.

PSAS are principle based -- they are not a set of specific prescriptive rules. Applying them requires the application of professional judgment.

Our professional staff exercises judgment in applying the standards and as necessary consult with external experts and advisors. They provide the Office of the Auditor General with their written analysis on all significant issues that impact the financial statements for the year being audited, and they discuss the issues with the Office of the Auditor General.

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Q. Are you going to hire an expert advisory panel, as you did on the pension asset accounting matter, to settle this dispute with the Auditor General? If so, what authority would this panel have?

There are no plans to establish a panel at this time.

In developing Ontario's Fair Hydro Plan (OFHP), 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 Province will continue to work with the Auditor General to build on the government's track record of responsible fiscal management and high quality financial reporting.

Independent Electricity System Operator (IESO)

The Auditor General was critical of the Independent Electricity System Operator's accounting changes, which formed part of her basis for a qualified opinion in the 2016-17 Public Accounts. Are these accounting changes inappropriate?

On recognizing market accounts' assets:

The Independent Electricity System Operator (IESO) began recognizing its market accounts' assets (amounts due from power distributors) and liabilities (amounts due to power producers) in its financial results. The IESO has chosen to recognize these markets accounts on its books for transparency reasons, as it better reflects its net financial position on behalf of the IESO-administered markets at year-end.

This accounting change was accepted by IESO's independent external auditor, which issued an unqualified, or "clean," audit opinion. These accounting changes were highlighted in the IESO's annual report which was published online in March 2017.

Further, this accounting is consistent with the presentation used previously by the Ontario Power Authority (which was merged with IESO on January 1, 2015) in its financial statements, which was not subject to qualification from the Office of the Auditor General (OAG) at that time.

This change has no impact to the Province's annual deficit, net debt or accumulated deficit.

This accounting change has been supported by the professional accounting staff of the Office of the Provincial Controller.

We will continue to work with the Auditor General to build on the government's track record of responsible fiscal management and high quality financial reporting.

On rate-regulated accounting:

The IESO made the decision to adopt rate-regulated accounting because it better reflects the economic substance of certain types of expenses that may not be directly recovered through the normal revenue requirement model.

The IESO, like Hydro One and Ontario Power Generation (OPG), is regulated by the Ontario Energy Board (OEB). The IESO adopted rate-regulated accounting for its year ended December 31, 2016. This accounting change was accepted by IESO's independent external auditor, which issued an unqualified, or "clean," audit opinion. These accounting changes were highlighted in IESO's annual report which was published online in March 2017.

Rate-regulated Accounting

Q. Why use rate-regulated accounting? What is its benefit?

In certain circumstances, an organization may be required to incur a large expenditure that will be recovered from ratepayers in the future.

For example, damage caused by an ice storm that results in extraordinary costs to restore a disruption of electricity services for customers. Such costs are subject to application and approval for recovery by the regulator over a specific time period.

What rate-regulated accounting does is it allows organizations to recognize those costs, which can be significant within a year but will generate benefits over time, to be matched over the same period that the amounts are recovered from ratepayers.

Q. The Auditor General says that the Independent Electricity System Operator's decision to adopt rate-regulated accounting was a deviation from Public Sector Accounting Standards, and cautioned against its use in her Independent Auditor's Report. Why was this change made and was it appropriate?

Canadian Public Sector Accounting Standards (PSAS) are effectively silent on this issue – they neither explicitly permit, nor prohibit, the recognition, measurement, presentation, or disclosure of rate-regulated activities.

In the absence of a clear position on an issue, standard accounting practice dictates that an entity should consult other accounting standards.

Paragraph 11 of the *Introduction to Public Sector Accounting Standards* ("Introduction") states: "When applying the CPA Canadian Public Sector Accounting (PSA) Handbook, where the standards are silent on an issue, public sector entities should apply Generally Accepted Accounting Principles (GAAP), Section PS 1150."

In this case, the Independent Electricity System Operator (IESO) consulted U.S. Generally Accepted Accounting Principles (GAAP), the appropriate accounting framework in North America that provides guidance on rate-regulated operations.

The IESO made the decision to adopt rate-regulated accounting because it better reflects the economic substance of certain types of expenses that may not be directly recovered through the normal revenue requirement model.

The IESO, like Hydro One and Ontario Power Generation (OPG), is regulated by the Ontario Energy Board (OEB). The IESO adopted rate-regulated accounting for its year ended December 31, 2016. This accounting change was accepted by IESO's independent external auditor, which issued an unqualified, or "clean," audit opinion. These accounting changes were highlighted in IESO's annual report which was published online in March 2017.

It is worth noting that currently 8 out of 9 electricity system operators in North American markets employ accounting for rate-regulated assets, including IESO.

Q. The Auditor General says that the use of rate-regulated accounting is inappropriate for the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB) according to U.S. Generally Accepted Accounting Principles. How do you respond?

In commenting on the use of rate-regulated accounting and the role of the Ontario Energy Board (OEB), the Auditor General's report makes reference to a requirement under U.S. accounting standards in connection with the use of rate-regulated accounting that "there must 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 to not 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 of which 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.

IESO Response:

Canadian Public Sector Accounting Standards (PSAS) are effectively silent on this issue – they neither explicitly permit, nor prohibit, the recognition, measurement, presentation, or disclosure of rate-regulated activities.

In the absence of a clear position on an issue, standard accounting practice dictates that an entity should consult other accounting standards.

In this case, the Independent Electricity System Operator (IESO) consulted U.S. Generally Accepted Accounting Principles (GAAP), the appropriate accounting framework in North America that provides guidance on rate-regulated operations.

Legislated Accounting

Q. The Auditor General says that you are essentially making up your own accounting rules. How are Ontarians supposed to believe things like a “balanced budget” when you keep changing the rules?

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 the government has with the Auditor General’s report.

The OFHP operates under a financial and accounting framework that is appropriate for its intended purpose. It is in accordance with Public Sector Accounting Standards (PSAS) and ensures the goals underlying the program are achieved in a cost-effective manner.

The Province, as always, will prepare its consolidated financial statements in accordance with Public Sector Accounting Standards (PSAS). The recording of any asset resulting from transactions of OFHP will be assessed for recognition and measurement based on PSAS, and where appropriate, other accounting guidance where PSAS is silent on the issue.

Q. The Auditor General says that the Province legislated accounting through the Ontario Fair Hydro Plan Act, which is not allowed according to Public Sector Accounting Standards (PSAS). Is this true?

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 the government has with the Auditor General's report.

The Province, as always, will prepare its consolidated financial statements in accordance with Public Sector Accounting Standards (PSAS).

As PSAS is set by an independent standard-setting body in Canada focused specifically on the public sector, and because PSAS is used by all senior governments in Canada, presenting financial statements in accordance with PSAS results in transparent financial reporting for the Province of Ontario.

PSAS are principle based – they are not a set of specific prescriptive rules. Applying them requires the application of professional judgment.

Our professional staff exercises judgment in applying the standards and as necessary consult with external experts and advisors. They provide the Office of the Auditor General with their written analysis on all significant issues that impact the financial statements for the year being audited, and they discuss the issues with the Office of the Auditor General.

The role of the Ontario Energy Board (OEB) and its mandate is provided in legislation. It is not uncommon for government policy, through regulations, to provide the ground rules over which the OEB is to preside.

This is the case with Ontario's Fair Hydro Plan (OFHP) itself, as the Act and the various regulations provide the direction and processes over which the OEB is to exercise oversight, review, and make conclusion on submissions brought forward.

Relationship with the Office of the Auditor General

Q. The Auditor General alleges the government withheld information from her on the accounting treatment for Ontario's Fair Hydro Plan. Why would she say that?

The government is committed to assisting the Office of the Auditor General so that it can provide its independent views to the Legislative Assembly.

The implementation of Ontario's Fair Hydro Plan is ongoing, with significant accounting and financial decisions still being finalized.

Senior ministry officials have met and continue to work with the Office of the Auditor General by participating in interviews and providing documentation.

If pressed:

The Auditor General was informed throughout the course of this process.

If asked about the Ministry of Energy emails:

The Ministry of Energy, Finance, and the Treasury Board Secretariat are committed to assisting the Auditor General. For questions related to the Ministry of Energy, please contact them directly.

Future Governments

Q. The Auditor General says that you are essentially handcuffing future governments with your financing structure. Why should future governments have to pay for your decisions?

By responsibly managing the Province's finances, Ontario balanced the budget in 2017-18, and will maintain a balanced budget for the future.

With a growing economy and a balanced budget, this is the time to make investments in key services that matter most to people, like health care and education, while at the same time lowering costs for necessities like electricity and child care.

Over the last decade government policies have supported rebuilding the electricity transmission and distribution grid, invested in clean generation, and closed the last coal-fired power plant. Prices have increased because our electricity system is being transformed – more than \$70 billion⁴⁴ has been invested to modernize the system.

The government heard from people across the Province that the price of electricity had risen too quickly, which is why Ontario's Fair Hydro Plan (OFHP) will ensure costs are shared more fairly over the years ahead.

The Ontario electricity sector invested in renewing the provincial electricity system, including many new generating facilities, most of which operate under 20-year contracts. Some of these generators are expected to provide value to the electricity system beyond their contract lives. There is an opportunity to recognize the long-term benefit of these assets to the electricity system and "bring forward" that benefit for ratepayers today by deferring some of the current costs.

To relieve the current burden on ratepayers and share costs more fairly, a portion of the Global Adjustment (GA) is being refinanced. Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built.

In the early years, a portion of the costs covered by the GA is being refinanced to reduce pressure on today's electricity ratepayers. In later years, the cost of refinancing will be recovered from ratepayers.

OFHP is delivering the single-largest reduction in electricity rates in the Province's history. In developing OFHP, 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.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose and ensures the goals underlying the program are achieved in a cost-effective manner.

⁴⁴ Ministry of Energy, *2017 Long-Term Energy Plan*

The government recognizes that a fiscally sound approach to managing the Province's finances will provide the foundation for the long-term well-being and prosperity of Ontarians, and protect the public services that Ontarians rely on.

For further questions related to Ontario's Fair Hydro Plan, please contact the Ministry of Energy.

Asset Sales

Q. Will you buy back Hydro One so that it is back under public control?

Maximizing the value of designated assets is part of the government's economic plan for Ontario. The net revenue gains from these transactions are helping the government to deliver on its plan by investing in infrastructure.

The Trillium Trust Act, 2014, provides for the dedication to the Trillium Trust of net revenue gains associated with the sale of designated assets to support investments in transit, transportation and other priority infrastructure across the province.

The Province has also committed to using the cash amount of the proceeds related to the book value of the Hydro One shares sold to pay down the Province's electricity sector debt and other payables, helping to reduce the debt of the Ontario Electricity Financial Corporation (OEFC), which manages and pays down the debt and other liabilities of the former Ontario Hydro.

The government is on track to generate, over time, \$4 billion⁴⁵ in net revenue gains to be invested in transit and infrastructure, along with \$5 billion⁴⁶ to reduce debt, from broadening Hydro One's ownership.

The government will remain, by law, the largest single shareholder in Hydro One, restricting the Province from selling down to less than 40%⁴⁷ of the voting securities in Hydro One – and no other single shareholder or group of shareholders working in concert will be permitted to hold more than 10%⁴⁸ of the company's shares.

⁴⁵ Ontario Financing Authority

⁴⁶ Ontario Financing Authority

⁴⁷ Ontario Financing Authority

⁴⁸ Ontario Financing Authority