

From: [Gavin He](#)
To: [John Kim](#); [Bruno Amara](#)
Cc: [Ronald Kwan](#)
Subject: FW: Auditor General Bonnie Lysyk to The Standing Committee on Justice Policy on Bill 132 Ontario Fair Hydro Plan Act, 2017—May 24, 2017
Date: Wednesday, May 24, 2017 1:06:04 PM
Attachments: [Auditor General on Fair Hydro.pdf](#)
[ENERGY's Fair Hydro Plan Legislation Intro OA'S - May 11, 2017 APPROVED.....docx](#)
[MOF OAs FAO Fair Hydro Plan_v4_ext_May 23.docx](#)
[Global Adjustment_HBN_v5_Energy edits_May 18 2017.docx](#)
Importance: High

Hi John/Bruno,

Please see the first attachment the comments from AG on the FHP. Please let me know if we will be updating the Q&A's, or should that go to Energy.

Thanks,
Gavin He

From: Spadoni, Peter (MOF) [mailto:Peter.Spadoni@ontario.ca]
Sent: Wednesday, May 24, 2017 12:46 PM
To: Birks, Ryan (MOF) <Ryan.Birks@ontario.ca>; Gavin He <Gavin.He@ofina.on.ca>
Cc: Hsu, Priscilla (MOF) <Priscilla.Hsu@ontario.ca>
Subject: RE: Auditor General Bonnie Lysyk to The Standing Committee on Justice Policy on Bill 132 Ontario Fair Hydro Plan Act, 2017—May 24, 2017
Importance: High

Hi Ryan and Gavin – the AG has made comments on the Fair Hydro Plan, specifically about accounting methods. Do you think TBS will need to update the attached CIN note? Or is this a question for ENERGY?

HBN:

IF ASKED ABOUT ACCOUNTING METHODS FOR GLOBAL ADJUSTMENT:

- Under the proposed structure, the Province's net debt and annual surplus/deficit is not expected to be negatively impacted since all costs are expected to be recovered through future rates.
- However, there is still much to be done in terms of working out the remaining details through regulations and commercial agreements.
- The fiscal impact to the Province will only be known once those details are finalized.
- The Ministry of Finance continues to work closely with Treasury Board Secretariat, the Ministry of Energy, OPG, the IESO and external advisors to address the outstanding accounting related considerations which will be key to managing the fiscal impact of the GA refinancing.
- The Auditor General has also been briefed on the proposed structure of the GA refinancing structure and will be advised of the government's proposed accounting

treatment once the necessary details are available.

Media Qs:

(from Energy) **Q88. Is the Auditor General going to agree with all of this accounting?**

We can't presuppose the work of the Auditor General. The government worked hard to assess all fiscal impacts and worked closely with both internal government and external accounting experts.

In crafting the proposed Fair Hydro Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.

(from Finance) **Q8. The FAO questioned whether the Province's proposed accounting treatment meets public sector accounting standards. Is the government collaborating with the Auditor General of Ontario (OAGO) to clarify this issue?**

The government worked hard to assess all fiscal impacts and worked closely with both internal government and external accounting experts. Our government welcomes any input from the Auditor General to ensure all of the public sector accounting standards are met.

In crafting the proposed Fair Hydro Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.



Remarks by Auditor General Bonnie Lysyk to The Standing Committee on Justice Policy on Bill 132 *Ontario Fair Hydro Plan Act, 2017*

May 24, 2017

Good morning. I'm Bonnie Lysyk and I'm the Auditor General of Ontario. Thank you for letting me comment on Bill 132.

It is not the job of the Auditor General to comment on government policy. The government's decision to borrow money to lower hydro bills by 25% is a policy decision, and so I have no comment on it.

However, when it comes to the accounting for such a decision, it is my responsibility to make sure that it is properly recorded in the consolidated financial statements of the Province and is transparently reported to the people of Ontario. And this is why I am here today.

The accounting transaction is structured in a complex manner. In simple terms, the government plans to record as an asset the expected recovery of the 25% in electricity costs from future ratepayers that it will borrow for and pay to power producers today. In essence, it is setting up as an asset an accounts receivable that it expects to collect from future ratepayers between 2022 and 2047 that is not yet an accounts receivable because the consumer has not yet used the electricity.

A similar move to legislate accounting to defer costs was proposed with the restructuring of the Ontario electricity sector in the late 1990s. At that time, the government did not want the net impact of the stranded debt, which had already been incurred, to be reflected on the Province's financial statements. Because it anticipated that ratepayers would pay down this debt, it wanted to create an asset to reflect those future anticipated revenues from electricity ratepayers. This approach would have fully offset the total stranded debt, such that there would have been no net debt impact reflected on the Province's consolidated financial statements. The Auditor General's opinion, as stated in our Office's 2000 Annual Report, was that this [quote] "would have set an unacceptable precedent for government accounting. It would also have represented a departure from one of the central tenets of generally accepted accounting principles—that revenue not be recognized until it is earned." [end quote] The government heard these concerns and was prudent in making the decision to not create an asset for future anticipated ratepayer payments. I believe those concerns are equally applicable today.

The government of today plans to borrow about \$26 billion to cover the 25% shortfall from ratepayers, but it does not want to reflect the overall impact of these borrowings on the consolidated financial statements of the Province, which includes the electricity sector. It plans to record anticipated revenue as an asset to offset borrowings in its consolidated financial statements. As a result, there will be no

impact on net debt on the Province's balance sheet. As well, this legislation is designed so that there will be no impact on the Province's calculation of the annual surplus or deficit. Today, like in 2000, we believe this sets a dangerous precedent.

Let me give you an example. Snow plowing in Ontario is performed by private-sector contractors who own equipment. The contractors' bills are properly included as a government expense each year. Now, say the government decides that taxpayers are paying too much for snow plowing and points out that there is value in the snow plowing equipment beyond the term of the contracts. It could argue that it expects to negotiate significantly lower rates in future contracts and wants to defer some current snow plowing costs into the future to "smooth" these costs over time. For obvious reasons, this is not allowed under Canadian public-sector accounting standards. As we know, accounting deals with past transactions, not future ones. So to anticipate that private-sector electricity generators will reduce their costs in the future and to use legislation to make this potential future benefit an asset is also not allowed under Canadian public-sector accounting standards.

So what's the bottom line? I would not be doing my job as Auditor General if I said that creating assets through legislation is acceptable. 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.

I now welcome any questions you might have.

Fair Hydro Plan QA'S

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Key Messages

- **The proposed OFPHP legislation, supporting regulation and amendments to existing legislation (e.g. Electricity Board Act and Ontario Energy Board Act) will enable implementation of the following key components of the plan:**
 - 1. Refinancing the Global Adjustment (GA) – The proposed legislation outlines how costs would be fairly allocated among eligible consumers over time.**
 - 2. Helping Vulnerable Electricity Consumers – The proposed legislation broadens the Rural or Remote Protection Program (RRRP), expands the Ontario Electricity Support Program (OESP) and established a new On-Reserve First Nation Delivery Credit. The legislation also allows for these programs to be funded through the tax base.**
- **Ontario is committed to keeping electricity in Ontario clean, reliable and affordable.**
- **We've been making important investments in a cleaner and more reliable energy system for today and tomorrow.**
- **The decision to invest in a clean, modern and reliable electricity system was the right one — but the costs of this decision should not be put on today's electricity bills alone.**
- **We are moving forward with a plan that will ensure costs are shared more evenly.**
- **The new Fair Hydro Plan would bring in new initiatives that would cut costs directly on your energy bill.**
- **We are taking decisive action by proposing to lower electricity bills for households by 25 per cent on average — it would be the single-largest reduction in Ontario's history. These measures include the eight per cent rebate introduced in January and build on previously announced initiatives to deliver broad-based rate relief on all electricity bills.**
- **People with low incomes and those living in rural communities would benefit from even greater savings – as much as 40-50 per cent**
- **These are significant bill savings that will make a real difference.**
- **Ontario's Fair Hydro Plan includes:**
 - **Refinancing the Global Adjustment (GA) over a longer term period for Regulated Price Plan (RPP) eligible consumers, including families, small businesses and farms.**
 - **Helping vulnerable electricity consumers by enhancing electricity support programs and shifting costs off the electricity bill. We would be helping eligible customers by:**

- Establishing a new Affordability Fund which will support Ontarians who are not eligible for the OESP, Low-Income Energy Assistance Program or [Home Assistance Program](#) and who have difficulty paying their electricity bills.
 - Broadening Rural or Remote Rate Protection (RRRP) to provide on-bill relief for rural customers paying the highest distribution charges (rates?).
 - Expanding the Ontario Electricity Support Program (OESP) to help more people with higher on-bill credit amounts.
 - Removing delivery charges from the bills of on-reserve First Nations customers.
- Improving sector efficiency and modernizing Ontario's electricity market, working in collaboration with the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).
- Any rate increases over four years will be held to the rate of inflation.
- To implement the OFHP legislation, the Ministry has prepared legislation and regulations in close collaboration with key ministries, agencies, third party financial advisors, and local distribution companies (LDCs)
- Our government has put forth a series of measures to help make life more affordable. These include:
 - Introducing the Ontario Electricity Support Program
 - Introducing a rebate equal to the provincial portion of the HST to reduce bills by 8% pre-tax
 - Additional relief for eligible rural customers, and
 - Expanding the Industrial Conservation Initiative so more businesses can take advantage of it.

Questions and Answers

Fair Hydro Plan Overview

Q1. There are a number of different pieces to your Fair Hydro Plan. Can you please explain how these new and existing initiatives will help electricity ratepayers?

Over the last decade Ontario has rebuilt our transmission and distribution grid, invested in clean generation, and closed the last coal-fired power plant. Prices have increased because our energy system is being transformed – more than \$50 billion has been invested to modernize the electricity system.

We have heard from Ontarians across the province that the costs of these new investments have grown too quickly, which is why we are moving forward with a plan that would ensure costs are shared more evenly over the years ahead.

Ontario's Fair Hydro Plan (OFHP) would reduce the electricity bills of residential consumers by 25 per cent on average starting this summer. Increases would also be held to the rate of inflation for four years. Small businesses and farms would also benefit. These measures include the eight per cent rebate introduced in January and build on previously announced initiatives to deliver broad-based rate relief on all electricity bills. The Fair Hydro plan will deliver the single largest reduction to electricity rates in Ontario history.

Ontario's Fair Hydro Plan (OFHP) includes:

- Refinancing the Global Adjustment (GA) over a longer period for Regulated Price Plan (RPP) eligible consumers, including residential consumers and most small businesses and farms.
- Shifting cost recovery for Rural or Remote Rate Protection (RRRP) and Ontario Electricity Support Program (OESP) from electricity bills to the tax base, lowering the regulatory charges paid by ratepayers. Consumers of all sizes would benefit from this change.
- Helping vulnerable electricity consumers by enhancing electricity support programs, including:
 - o Broadening RRRP to provide delivery charge relief for the customers of the local distribution companies (LDCs) with the highest delivery charges. We currently support approximately 350,000 Ontarians living in rural or remote areas through RRRP. The enhancement would extend relief to approximately 800,000 households in total.
- Expanding the OESP, which provides relief directly on the bills of low-income consumers who have applied and meet the eligibility criteria. The expansion would increase OESP credits by 50 per cent and allow more Ontarians to benefit from the program.

- o Establishing a new Affordability Fund, which would provide financial support to lower-income Ontarians who are not eligible for the [Home Assistance Program](#) to make home energy efficiency improvements, helping to manage their energy costs.
- o Establishing a Delivery Credit to eliminate delivery charges for all First Nations people living on reserve.
- Expanding the Industrial Conservation Initiative (ICI), which allows large consumers to reduce their electricity bills by up to one-third by reducing their consumption during peak hours. The expansion will allow manufacturers and greenhouses between 500 kW and 1 MW to participate, in addition to the consumers over 1 MW that are already eligible.
- Ontario's Fair Hydro Plan would also commit us to reducing system costs by improving sector efficiency and modernizing Ontario's electricity market, working in collaboration with the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

Q2. Once legislation is passed, how soon will rate updates take effect?

This proposed legislation includes the provision that gives the OEB 15 days from Royal Assent to determine updates to the Regulated Price Plan rates, enabling customers to receive the full benefit of the Fair Hydro Plan.

Q3. How much will these initiatives cost?

To relieve the current burden on consumers, two streams of initiatives are being undertaken.

In the early years, a portion of the costs covered by the GA would be financed to reduce pressure on today's electricity consumers. In later years, the cost of financing would be recovered from consumers.

Under current forecasts, the immediate reduction in the GA would be about \$2.5 billion per year on average over the first 10 years, with annual interest costs not exceeding \$1.4 billion.

Second. The province is proposing to introduce and expand existing rate relief programs.

A number of important programs such as the Ontario Electricity Support Program (OESP) and the Rural or Remote Rate Protection (RRRP) Program would now be funded from provincial revenues instead of by electricity consumers. The province is also launching a new Affordability Fund, enhancing the existing OESP and providing on-reserve First Nations with a delivery credit. Combined, these new measures would cost the government up to \$2.5 billion over the next three years.

We are developing the 2017 Long Term Energy Plan (LTEP) which will include a projection of future electricity costs.

Q4. What took you so long? How are you just realizing this now?

The Fair Hydro Plan is part of a significant system restructuring that would address long-standing policy challenges and ensure greater fairness over the next three decades. It is crucial that we get it right.

While the government has taken steps to address rates with targeted relief and support programs - it was not enough.

For decades governments pushed off the price of reinvesting in the system. This put too much of the burden on a single generation of ratepayers.

People want to know three things:

- First, that relief – substantial relief – is on its way.
- Second, that the relief will go to everyone
- And third, that the relief will be lasting because it is built on a real change.

And that's why the government is proposing the structural change to the system that will give Ontarians relief on their bills.

Q5. How is this different from what was done in the past?

This proposal is a significant structural change that represents a fair solution to an issue that's been unfairly placed on one generation of ratepayers. This is not a temporary solution, and it does not sacrifice investments in the energy system. The government is proposing to change the way electricity costs are recovered, and to move funding for assistance programs off of hydro bills. This plan is the biggest rate reduction in Ontario's history.

Q6. Isn't artificially freezing rates what got us into trouble in the first place?

We've already invested over \$50 billion in badly needed improvements to our electricity system. These investments will last Ontarians for generations to come, and it's only fair that more than one generation pays for them.

This is a significant structural change that represents a fair solution to an issue that's been unfairly placed on one generation. This is not a temporary solution, and it does not sacrifice investments in the energy system.

The government is proposing to change the way electricity costs are recovered, and to move funding for assistance programs off of hydro bills. This plan would result in the biggest rate reduction in Ontario's history.

Q7. The figure of 25 per cent savings is for a typical residential consumer. How much money will households actually save?

When we looked at how to make the system fairer, we wanted to make sure that these measures will benefit everyone.

Refinancing the Global Adjustment (GA) impacts the electricity line of the bill. So for example, in a typical household connected to Toronto Hydro and consuming 750 kWh per month, the reduction would be 25 per cent in 2017.

The reduction would vary depending on a number of factors, including how much electricity you use and the rates charged by your local distribution company.

Q8. Were there any outside experts that disagreed with what you're doing?

In crafting the Fair Hydro Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.

Q9. How did you decide how much to reduce rates by – 25%, 40%, 50%, etc.?

The amount of GA proposed to be smoothed out to later years reflects the projected lifespan of new generation built to update Ontario's electricity system. When combined with the 8 per cent rebate and shifting social programs to the tax base, the result is a significant rate reduction that will make a real difference in peoples' household budgets.

Q10. There are a lot of variables here – what is the chance this legislation won't work as planned?

In crafting the proposed Fair Hydro Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.

Q11. Will people's bills look different?

Most of the components of the plan do not require adjustments to the appearance of residential electricity bills.

We will work with the Ontario Energy Board (OEB) and Local Distribution Companies (LDCs) to ensure necessary changes are made to billing systems to reflect the impact of these initiatives.

LDCs already have experience with the implementation of billing changes like those associated with the OCEB and the Ontario Electricity Support Program (OESP).

Q12. You are characterizing these as structural changes. Does this mean the lower rates are permanent, or will rates rise again?

Any rate increases over four years will be held to the rate of inflation for typical residential electricity consumers.

We have a robust energy supply and are in a good position to improve efficiency, increase transparency, enhance opportunities for innovation and enhance competition to reduce system costs.

We are developing 2017 Long-Term Energy Plan (LTEP) which will include a projection of future electricity costs.

As part of the Ontario's Fair Hydro Plan (OFHP), the government will aggressively pursue cost reductions through sector efficiencies to mitigate costs over the long term.

Q13. Why isn't the 4-year inflation part of the plan in the legislation? Why can't you commit to this promise via legislation?

Regulations offer the flexibility to respond to potential fluctuations in inflation rates in any given year.

The Ontario Fair Hydro Plan Act, 2017, would if passed, allow future increases to hydro bills to be set by regulation. This enables the government's commitment to hold increases, for four years, to the rate of inflation. By including this measure in regulation, it offers the Province flexibility to respond to potential fluctuations in inflation rates in any given year.

Q14. You say you'll hold rates to increases of only inflation for 4 years – assuming that's 2% that brings you back to an 8% increase over those 4 years. How will that help Ontarians?

This proposal is a significant structural change that represents a fair solution to an issue that's been unfairly placed on one generation. This is not a temporary solution, and it does not sacrifice investments in the energy system.

We realize that energy bills have gone up too quickly in the past 10 years, so holding any future increases to the rate of inflation allows Ontarians to adjust accordingly and plan ahead. We believe this is a fair structural change to the system.

Additionally, it's difficult to implement savings in the short-term and takes a significant period of time to properly structure long-term savings across the energy system. This is primarily due to the complexities in the system and all the partners involved. That's why we have committed

to holding rates for 4 years – allowing us to implement significant short-term savings, and also develop a long-term plan for additional savings in the 5th year and beyond.

Q15. When will the ‘Fair Hydro Plan’ expire?

Our proposed Ontario Fair Hydro Plan Act, 2017, with our other initiatives, would, if passed, lower rates by 25 per cent on average across the province for all residential customers and as many as half a million small businesses and farms,. The government has committed to hold increases to the rate of inflation for four years.

Under GA refinancing, initial analysis indicates that borrowing would occur for about 10 years. Initial analysis indicates that it is currently anticipated that loans will begin to be paid back in the mid-to-late 2020s. The exact timing will be determined by the markets and other factors as we strive to balance costs and benefits in the fairest way possible. This is a significant structural change that represents a fair solution to an issue that has unfairly burdened current electricity ratepayers. This does not sacrifice investments in the energy system. We’re changing the way electricity costs are recovered, and moving funding for social programs off of hydro bills. This plan would deliver the biggest rate reduction in Ontario’s history.

Q16. How long are you talking about refinancing for?

Our proposal would spread costs over a 30-year period. This is a more fair approach that more accurately reflects the lifespan of our generation assets, and spreads the cost out among those people who will use them.

Q17. Why are you saddling our kids with billions of dollars of debt?

In the past few years we’ve invested more than 50 billion dollars in electricity infrastructure – new dams in the south, new towers in the north, and we plan to spend 13 billion dollars to refurbish nuclear power plants. These are enormously important assets that meet the demand for cleaner and reliable power everywhere in the province.

But we asked one generation – today’s generation – to unfairly shoulder the burden of nearly all those costs. We had to play catch-up and we asked today’s ratepayers to cover nearly the whole tab.

Think of it in terms of a mortgage. We needed to rebuild the system and so we went to the bank for that money. The mistake we made was setting terms that weren’t fair – particularly the amortization. Instead of paying off the mortgage over 30 years, we agreed to a term of 20. That means we pay things down faster. But the monthly mortgage payments – or, in this case, your hydro bills – are higher. And it doesn’t really make sense since that house – or in this case the electricity system – is an asset that will continue to benefit people far past that ten year window. In effect, this generation is subsidizing not just those who came before, but those who will come next.

It was a mistake – and it has been notably unfair on today’s hydro users. So we’re fixing that.

We're renegotiating the mortgage and setting a new term that stretches over a longer period. Over time, it will cost a bit more. And it will take longer to pay off. But it is fairer – because it doesn't ask this generation of hydro customers alone to pay the freight for everyone before and after. The burden now will be shared more evenly and more appropriately.

Q18. Doesn't this lower the incentive to conserve energy? It's against all your conservation efforts.

Our government remains committed to putting conservation first. Conservation is good public policy - it empowers individuals to lower their own bills, while reducing system costs and saving all Ontarians the cost of new generation and transmission infrastructure.

We will continue to encourage and support to ratepayers who are looking to lower their bills through conservation, by providing incentives and rebates through saveONenergy programs

Q19. Will you negotiate an additional 5% off bills with the federal government?

This is up to the federal government.

Q20. Why not just legislate contracts on the private sector generators?

We have already negotiated where we could - Samsung saved an estimated \$3.7 billion in costs. We also received independent expert advice that said if we were to renegotiate, not only is it completely uncertain if we would get benefits, but the benefits would be negligible compared to the systemic changes we announced today.

The renegotiation process would be extremely complex and lengthy, and the advice we received stated that it is very unclear that the end result would be in the interest of ratepayers without any form of taxpayer subsidy.

The potential positive impacts are extremely small, not to mention potential litigation.

Q21. Why are you saying an average of 25%? Are some getting 50% while others get 0%?

We are proposing to triple the size of the cut we're making to people's hydro bills from 8 per cent to an average of 25 per cent. Electricity rates in Ontario would come down significantly, they're going to stay down and everyone would benefit.

The cut would go to all households that pay for electricity. There will be no asterisks, no loop holes and no exceptions. And for those living in rural communities or with low incomes the break would be even greater – up to 40 to 50 per cent.

Q22. How much will this cost?

The last decade has seen massive investments in improving our system. These costs need to be recovered, but it needs to be fair.

Part of that means moving the cost of social programs from the rate base to the tax base, and expanding this support to certain vulnerable groups. The fiscal impact of this move would be

\$2.5 billion over the next three years - this cost is additional to our expenditure on the 8 per cent rebate.

And part of that means sharing some of the costs of these investments with the future ratepayers who would continue to benefit from them. This element - the GA refinancing - would not impact the fiscal plan.

Q23. How can you ensure this is feasible? What if interest rates go up and it impacts your borrowing?

The government has built in conservative estimates in our financial calculations. There's always a chance that interest rates rise or fall, but we are confident that we built in the necessary buffer in our estimates by using higher rates than are currently forecasted.

Q24. Will any proceeds from cap and trade be used for the relief package? NGOs have been asking.

No.

Q25. We're at the end of the legislative session – are you speeding this through to avoid scrutiny?

Our promise has been to deliver real rate relief to Ontarians by this summer. We have consulted extensively with experts within and outside of government to craft a solution that will deliver substantial rate reductions to all households, and as many as 500,000 small businesses and farms.

Fair and Clean Energy Adjustment

Q26. The Government has always insisted that the Ontario Energy Board (OEB) is a quasi-judicial organization that is responsible for setting electricity rates in Ontario. Does this legislation effectively take that power out of their hands?

The Ontario Energy Board (OEB) would continue to play an important role under the proposed Fair Hydro Act, 2017. The proposed legislation would provide authority to ensure that Ontario's Fair Hydro Plan can be properly and effectively put in place to give consumers the price reductions this government has promised.

In the early years, it is intended that a portion of the costs covered by the GA would be refinanced to reduce pressure on today's electricity ratepayers. In later years, the cost of refinancing would be recovered through adjustments to consumer invoices.

The OEB would continue to play its important role as regulator for the electricity sector. In particular, it would continue to set commodity rates for Regulated Price Plan (RPP) consumers, including any cost reductions under the OFHP in the near term.

The OEB would determine the required adjustments to consumer invoices to recover deferred GA amounts. The OEB would also be responsible for approving administrative fees related to certain activities in respect of the GA refinancing.

Global Adjustment & Debt Refinancing

Q27. What is the Global Adjustment (GA)?

The Global Adjustment (GA) accounts for the fixed costs of running Ontario's generation fleet, as well as the cost of conservation programs.

The GA is instrumental in maintaining a reliable electricity system by ensuring that sufficient generating capacity is available.

Q28. What changes are you making to the GA?

We have heard from Ontarians that costs are putting too much pressure on their electricity bills.

As we invested in renewing our electricity system, we invested in many new generating facilities, most of which operate under 20-year contracts, which means GA has increased in the near term to recover those costs, but we forecast that GA will eventually stabilize and decline in the future.

If passed, the proposed legislation would mean that starting this summer, the average residential electricity bill would be 25 per cent lower. Cost impacts are based on a forecast for a household connected to Toronto Hydro that consumes 750 kWh per month. Actual ratepayer savings would vary due to differences in consumption patterns.

If asked for more detail:

The majority of the province's electricity generators are 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. GA refinancing would spread these costs over a longer period and provide immediate ratepayer relief.

By recognizing that generation assets are expected to continue to provide benefit to future ratepayers, beyond the term of current contracts, future ratepayers are expected to be able to utilize these assets and reduce the need to finance the development of new generation assets.

Q29. How much debt are you borrowing?

The last decade has seen massive investments in improving our system. These costs need to be recovered, but it needs to be fair.

Part of that means moving the cost of social programs from the rate base to the tax base, and expanding support to certain vulnerable groups. The fiscal impact of this move would be \$2.5B over the next three years - this cost is additional to our expenditure on the 8% rebate.

And part of that means sharing some of the costs of these investments with the future ratepayers who will continue to benefit from them. This element - the GA refinancing - is not expected to impact the fiscal plan.

Initial analysis indicates that the accumulated debt would not exceed \$28 billion, including interest.

Q30. What will be the total interest paid on the accumulated debt?

Initial analysis indicates that total interest will not exceed \$25 billion.

Q31. Will all ratepayers (residential, commercial, industrial) benefit from the changes to the GA? If so, what kind of savings will a typical ratepayer see on their monthly bill?

Electricity consumers that are eligible for the Regulated Price Plan will benefit from the changes we are making to the Global Adjustment charge.

If passed, the proposed legislation would mean a typical residential consumer would see a bill reduction of 25 per cent. Small business and farms would also receive the benefit.

Q32. How will the changes to the affect the Hourly Ontario Electricity Price (HOEP)? Are there impacts that could affect pricing for certain customers?

The function of the wholesale electricity market will not change and the Hourly Ontario Electricity Price will continue to be set as normal.

Q33. How does the borrowing work? In tranches?

Leveraging the expertise of both organizations, the government has introduced legislation that would enable the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG) to work together to finance certain clean energy costs within the global adjustment (GA) over a longer period of time.

Under the proposed legislation, OPG would develop a financing plan, which sets out the funding obligations and amounts related to the financing of the deferred GA amounts. This plan would be submitted to the Minister of Energy. The Ontario Energy Board (OEB) would continue its role as regulator for the electricity sector. In particular, it would continue to set commodity rates for Regulated Price Plan (RPP) consumers, including any cost reductions under the Fair Hydro Act, 2017. Debt and financing costs would be recovered through adjustments to consumer bills.

Borrowing is expected to be done in tranches, as set out in the Financing Plan developed by OPG.

Q34. Why was OPG chosen as the entity responsible for the GA financing?

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

OPG currently manages an \$18 billion nuclear fund and can use its infrastructure and expertise in this field to help administer the GA financing.

As an entity regulated by the Ontario Energy Board (OEB), OPG also has extensive experience with regulatory deferral and variance accounts.

Q35. What happens if the OEB doesn't allow OPG/IESO to recover the exact amount it has borrowed? Will this saddle us with more unwanted debt?

The proposed Fair Hydro Plan legislation is written to prevent such a scenario. The proposed Act, together with amendments to the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*, would enable Ontario Power Generation (OPG), the Ontario Energy Board (OEB), and the Independent Electricity System Operator (IESO) to address payment, settlement and cost-recovery obligations and to manage the refinanced GA costs. The transaction is expected to be fiscally neutral to the province.

Q36. Is there going to be a new CEO of this OPG entity?

The financing entity would be managed by a board appointed by OPG.

OPG has a great deal of experience managing the risks associated with borrowing through their experience developing capital-intensive generation projects as well as their management of Nuclear Funds.

Q37. Is this entity within OPG or IESO?

Leveraging the expertise of both companies, the government intends to introduce legislation that would enable the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG) to work together to finance certain clean energy costs within the global adjustment over a longer period of time.

OPG, in its role as Financial Services Manager, would create the appropriate entity within which to manage its Financing Plan. Under the proposed legislation, OPG would develop a financing plan, which sets out the funding obligations and amounts related to the financing of the deferred Global Adjustment (GA) amounts. This plan would be submitted to the Minister of Energy. The Ontario Energy Board (OEB) would be responsible for approving administrative fees related to OPG's role as Financial Services Manager in respect of the GA refinancing.

Q38. Does this financing entity report in to the government?

The entity would be directly accountable to OPG.

Q39. What accountability measures and oversight will government have over the OPG financing entity?

While OPG would have independence in appointing the board of the financing entity, OPG is ultimately accountable to its sole shareholder, the Minister of Energy.

Q40. Will you take advantage of the OFA's borrowing rates? Or will OPG secure their own?

OPG would finance the deferral of Global Adjustment through a mix of OFA financing and external private sector financing.

Q41. Could this level of borrowing/refinancing ultimately affect Ontario's credit rating?

The refinancing of the Global Adjustment would take place only within the electricity system – current ratepayers would pay less now, and future ratepayers in turn would help to pay for their fair share of the significant investments we've made to build a clean and reliable electricity system, free of burning dirty coal.

The refinancing is not expected to impact the fiscal plan.

Q42. What do you expect to happen after 4 years?

Based on current modelling, we project that borrowing will continue for about 10 years . Initial analysis indicates that it is currently anticipated that consumers will begin to repay the borrowed amount in the mid-to-late 2020s The exact timing will be determined by the markets and other factors as we strive to balance costs and benefits in the fairest way possible.

In the meantime, the government and our agencies are working hard to reduce system costs and to give consumers more choice. The IESO is embarking on a Market Renewal project to improve the way we procure and dispatch energy, which will save costs. And the OEB is piloting projects to give customers greater flexibility in how they consume and pay for electricity. These measures will help ensure that electricity bills stay low in Ontario.

Q43. What if financiers don't want to buy your debt?

In crafting the proposed Ontario Fair Hydro Plan Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.

Q44. You say you want to ensure fairness for this generation – how can you ensure fairness for our kids and grandkids if you’re borrowing billions?

Future generations would 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.

The proposed Fair Hydro Plan acts much like taking out a new mortgage – providing much-needed relief now by spreading costs across the life of our assets. Current ratepayers would pay less now, and future ratepayers in turn help to pay for their fair share of the significant investments we’ve made to build a clean and reliable electricity system, free of burning dirty coal. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Q45. Who will be responsible for the accumulated debt of GA financing? The ratepayers or the taxpayers? Will it contribute to the province’s debt?

The government is dedicated to reducing electricity costs wherever possible, while maintaining reliability for all consumers.

With the proposed Fair Hydro Plan and as a result of the government's prudent fiscal management, the Ontario government is delivering on its commitment to balance the budget this year, recognizing that balance provides the foundation for the long-term well-being and prosperity of Ontarians.

To relieve the current burden on ratepayers and share costs more fairly, it is proposed that a portion of the GA would be refinanced. Refinancing the Global Adjustment (GA) would provide 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, it is intended that a portion of the costs covered by the GA would be refinanced to reduce pressure on today's electricity ratepayers. In later years, the cost of refinancing would be recovered from ratepayers.

Q46. People have been paying for investments to make the system cleaner and more reliable. Now, you are spreading these costs over the longer term. Aren’t you just offloading costs to future generations?

We have been making important investments in a cleaner and more reliable energy system, and we are reaping the benefits of that, but these investments have led to higher electricity bills.

Most of Ontario’s electricity generators are under 20-year contracts, but many of these facilities will continue to generate power after their contract ends. These are long-term assets for our electricity system. We are bringing forward some of the value of these assets by spreading some of the current costs of these contracts over a longer period.

Q47. Won’t spreading these costs over more years lead to big rate hikes down the road?

Many of the generating facilities that have been developed recently are expected to operate past their contract life. We are recognizing that some generating facilities will continue to provide benefits to future electricity consumers after their contracts end. This will reduce the need for future consumers to finance the development of new generating facilities.

Q48. Residential customers just stopped paying the Debt Retirement Charge (DRC) and business and industrial customers are still paying it until 2018. Why are you now adding more debt to ratepayers?

We have a plan that significantly reduces rates today AND ensures fairness and predictability for tomorrow.

Most of Ontario's electricity generators are under 20-year contracts, but many of these facilities will continue to generate power after their contract ends. These are long-term assets for our electricity system. We are bringing forward some of the value of these assets by spreading some of the current costs of these contracts over a longer period. This will reduce the need to finance the development of new generation assets.

Program Enhancements

Q49. The new Fair Hydro Plan will also bring savings to Ontario consumers through electricity support programs. What are these programs and who will benefit?

Eligible consumers will receive additional funding through assistance and conservation programs including:

- Establishing a new Affordability Fund which will support Ontarians who are not eligible for the [Home Assistance Program](#) and struggle to pay their electricity bill.
- Broadening Rural or Remote Electricity Rate Protection (RRRP) to provide Delivery Charge Relief for the customers of the local distribution companies (LDC's) with the highest delivery charges.
- Expanding the Ontario Electricity Support Program (OESP) to increase participation and provide further assistance to eligible participants.
- Removing the delivery charge from the bills of on-reserve First Nations customers.

Q50. Why aren't you targeting relief to those who need it most instead of providing breaks to everyone?

We understand rising electricity costs are a concern for all Ontarians and appreciate that low-income Ontarians feel it even more. While all communities will benefit, we've taken extra steps protect the most vulnerable.

We currently offer both the Ontario Electricity Support Program and the Rural and Remote Rate Protection, which offer significant on-bill benefits to eligible households. As part of our Fair Hydro Plan, these programs are being enhanced to ensure vulnerable consumers receive additional support.

For those most in need, low-income programs like the Home Assistance Program provide energy efficiency upgrades in homes at no cost to help customers reduce future electricity bills and avoid future disconnections.

We recognize that there are other electricity customers who are in need, but who do not qualify as low-income, and are helping address this through the Affordability Fund.

Q51. How are you changing the way programs are currently funded?

As a government, we have been focused on ensuring that our electricity system has been fairer for families living in rural areas or with low incomes.

Programs designed to support customers that are most vulnerable to increasing electricity costs will shift from the hydro bill to government funding, recognizing they are for the common good. This includes the Ontario Electricity Support Program (OESP) and Rural and Remote Rate Protection (RRRP).

The new Affordability Fund and the On-Reserve First Nation delivery rate will also be government-funded. This ensures that initiatives designed to provide a social good will be better aligned with the government's poverty reduction goals.

Q52. This announcement is only for residential customers. What are you doing for industrial consumers?

Industrial customers will benefit through two initiatives.

A number of important programs such as the Ontario Electricity Support Program (OESP) and the Rural or Remote Rate Protection (RRRP) program would now be funded from provincial revenues instead of by electricity consumers. This will provide savings to industrial customers, who currently fund a portion of these programs.

We are also proposing to expand the Industrial Conservation Initiative (ICI) to include smaller manufacturers with peak demands between 500 kW and 1 MW. ICI provides a strong incentive for participating consumers to shift their electricity consumption to off-peak hours to reduce their bills by about one-third. By reducing the province's peak demand, ICI has the added benefit of deferring the need to build peaking generation. Participating consumers collectively reduced Ontario's peak demand by an estimated 1,000 MW in 2015.

OESP

Q53. What are you doing for low-income Ontarians?

Through the Fair Hydro Plan, we are providing relief to everyone and also providing additional relief for those who are most in need of support.

This includes expanding the Ontario Electricity Support Program, which lowers electricity costs for the most vulnerable customers by providing a rebate directly on their bills. This program — which is income-tested and application-based — uses two scales: basic credits; and an enhanced credit for Indigenous people and for people who use electric heat or certain

electrically intensive medical devices.

Effective May 1, 2017, the eligibility for OESP is expanding so that more Ontarians can receive the credit. OESP credits are also increasing by 50 per cent. Here is what that means for OESP recipients:

- Single, low-income consumers who receive the lowest credit amount received \$30 per month (\$360 per year). They will now receive \$45 per month (\$540 per year).
- There is also an enhanced credit for customers with unique electricity requirements, including electric heating, certain medical devices that use a lot of electricity, or Indigenous customers.
- For a single, low-income customer eligible for the enhanced credit, the amount is growing from \$45 per month (\$540 per year) to \$68 per month (\$816 per year).
- Families of 4 who receive the OESP could qualify for 3 different credit amounts, depending on their income. Please visit:
<https://www.oeb.ca/sites/default/files/backgrounder-OESP-20170426.pdf> for more information on the different credit amounts, and who qualifies.

We are moving to have the OESP funded by the tax base, which will reduce regulatory charges on electricity bills for all Ontario ratepayers.

Q54. There hasn't been huge uptake of the Ontario Electricity Support Program (OESP). What are you doing to increase participation levels in this program?

We want to ensure that people receive the support they need and are eligible for, and are taking a number of steps to increase participation in this program:

- Increasing awareness of the program to eligible recipients
- As of May 1, 2017, OESP credit amounts increased by 50% and additional eligibility was added to benefit more low-income consumers in Ontario.
- ENERGY, the OEB, and the Ministry of Community and Social Services (MCSS) are developing a strategy to support and increase OESP participation levels. Pending legislative approval, this will:
 - Raise awareness of OESP through communication to social assistance clients who may qualify for the program
 - Incorporate OESP enrolment into the social assistance intake process

Q55. Can you provide more details about each of these existing programs? What is the Ontario Electricity Support Program (OESP)? Who was eligible to receive the OESP and how much did the average household receive before these new measures?

The government recognizes that that the price of electricity can be difficult for those that pay a higher share of their income towards the bill – particularly low-income families and seniors on a fixed income.

For many low-income Ontarians, paying their electricity bill can be a challenge, with this monthly expense representing a greater portion of their income.

That is why the OEB developed the Ontario Electricity Support Program (OESP), which provides an ongoing rate reduction directly on the bills of low-income electricity consumers who have applied and meet the eligibility requirements.

Before these measures, OESP monthly credits range from \$30 to \$50. A household receiving the lowest OESP credit would receive \$360 per year off their bills, or \$425 per year when combined with the removal of the Debt Retirement Charge (DRC).

Customers with unique electricity needs, such as customers using electric heating, customers relying on certain electricity intensive medical devices, and First Nation, Inuk, and Métis customers were eligible for an enhanced amount, ranging from \$45 to \$75 per monthly bill.

Q56. What is the Ontario Electricity Support Program (OESP)? Who is currently eligible to receive the OESP and how much does the average household receive?

The government recognizes that the price of electricity can be difficult for those that pay a higher share of their income towards the bill – particularly low-income families and seniors on a fixed income.

For many low-income Ontarians, paying their electricity bill can be a challenge, with this monthly expense representing a greater portion of their income.

That is why the OEB developed the Ontario Electricity Support Program (OESP), which provides an ongoing rate reduction directly on the bills of low-income electricity consumers who have applied and meet the eligibility requirements.

OESP monthly credits range from \$30 to \$50. A household receiving the lowest OESP credit would receive \$360 per year off their bills, or \$425 per year when combined with the removal of the Debt Retirement Charge (DRC).

Customers with unique electricity needs, such as customers using electric heating, customers relying on certain electricity intensive medical devices, and First Nation, Inuit, and Métis customers are eligible for an enhanced amount, which ranges from \$45 to \$75 per monthly bill.

Q57. How is the Ontario Electricity Support Program (OESP) currently funded? How will that change? And why are you now shifting the cost to government funding?

As a government, we've been focused on ensuring that our electricity system has been fairer for families with low-incomes.

Funding for programs designed to support customers that are most vulnerable to increasing electricity costs will shift from the hydro bill to government funding, recognizing they are for the common good. This includes the Ontario Electricity Support Program (OESP) and Rural and Remote Rate Protection (RRRP).

The new Affordability Fund and the On-Reserve First Nation Delivery Rate will also be delivered using government funding. This ensures that initiatives designed to provide a social good will be better aligned with the government's poverty reduction goals.

Q58. How much more will the monthly on-bill credit be as a result of today's announcement?

As part of the Fair Hydro Plan, OESP program benefits will increase across the board by 50%.

Single low income consumers eligible for the lowest credit amount will receive \$45 per month, an increase from the current \$30, or an increase of \$180 per year. For the enhanced credit, the lowest credit for single low income consumers is increasing from \$45 to \$68, or an annual increase of \$276.

Q59. Where will this money come from? How is this different from the current OESP funding model?

The OESP is a rate relief program that supports low-income customers through a per kilowatt-hour charge on every customer's electricity bills.

The government recognizes that the price of electricity can be difficult for those that pay a higher share of their income towards the bill – particularly low-income families and seniors on a fixed income. For many low-income Ontarians, paying their electricity bill can be a challenge, with this monthly expense representing a greater portion of their income.

This announcement means that greater focus and support can be placed on lower income Ontarians by enhancing the OESP through government funding, including a 50% increase in OESP credit amounts across the board.

This change will reduce costs for all consumers as a result of eliminating the OESP charge:

- Average residential customer savings: \$0.83/month; and
- Average industrial customer savings: \$1.10/MWh.

Q60. When will I see the additional credit on my electricity bill?

The credit will take effect this summer.

Q61. Will the additional credit be applied retroactively, i.e., to the date I received my first OESP credit?

The OESP started January 1, 2016, when the Ontario Clean Energy Benefit (OCEB) ended.

Existing customers will automatically receive the 50% increase in credit amount, effective May 1, 2017.

Q62. Can consumers who did not sign up for the program when it was launched in November 2015 sign up now? What is the deadline?

Customers can apply for the OESP any time.

There is no application deadline, but the sooner customers apply and are accepted into the OESP, the sooner they will begin to receive the on-bill credits.

Q63. How are you making these changes to the OESP? Are they a result of legislative changes? Regulation changes?

Changes to the OESP are being made through amendments to the *Ontario Energy Board Act, 1998* (OEBA), and through regulation O. Reg. 314/15.

RRRP

Q64. What are you doing for people in rural areas?

We currently provide support to roughly 350,000 rural residential customers through the Rural or Remote Electricity Rate Protection Program (RRRP). We will expand this support to provide rate relief also to customers of local distribution companies (LDCs) with some of the highest rates.

The enhanced program will benefit about 800,000 customers total. As an example, a Hydro One low density customer on electric heat consuming 2,500kWh/month will see their distribution charge reduced by about \$75. Specific rebate amounts will be dependent on Ontario Energy Board rate-setting processes.

We are moving to have the RRRP funded by the tax base, which will reduce regulatory charges on electricity bills for all Ontario ratepayers. We project this will cost about \$500 million in the 2017–18 fiscal year.

Q65. What is the Rural or Remote Rate Protection (RRRP) plan? Who is currently eligible to receive the RRRP and how much does the average household receive?

The Delivery charge on consumer bills includes the cost of delivering electricity from generating stations across the Province to homes and businesses via the high voltage (transmission) and low voltage (distribution) electricity systems and also includes the cost of distribution system losses.

The cost of distributing power to lower-density rural and remote areas is much higher than for urban and higher density areas.

To help offset the higher costs to distribute electricity to Ontario residents who live in rural or remote locations, eligible customers receive a credit off their bills under the Rural or Remote Rate Protection (RRRP) framework.

If the Fair Hydro Plan legislation is passed, customers served by the following LDCs would benefit from the expanded RRRP include: Hydro One R2 and R1 customers, Northern Ontario Wires, Lakeland Parry Sound, Chapleau, Sioux Lookout, InnPower, Atikokan and Algoma

Q66. The RRRP was recently updated on January 1, 2017. What kind of relief does it provide to ratepayers?

In recognition of the unique and special circumstances associated with the electricity cost-of-service for rural ratepayers, effective January 1, 2017, the province is reducing costs for eligible rural ratepayers by providing additional funding to the RRRP program.

Starting on January 1, 2017, 330,000 Hydro One low density (R2 class) customers will receive \$60.50 per month in RRRP to bring their total Delivery line costs to roughly \$78 for 1,000 kWh/month.

Q67. What further changes are you now making to the RRRP as a result of the Fair Hydro Plan?

Delivery Charge Relief will be provided for the customers of the local distribution companies (LDCs) with the highest delivery charges.

In addition to RRRP, which mitigates the specific costs related to low-density distribution service, Delivery Charge Relief will be broadened to harmonize distribution costs at the lowest rate amongst the eligible LDCs – eliminating some of the inequities caused by variation in distribution rates across the Province.

The additional relief is expected to decrease total electricity bills by an average of \$540 a year or \$45 each month. About 800,000 customers will benefit from the enhanced RRRP program.

Q68. How is this different from the current RRRP funding model?

RRRP funding is currently collected from all Ontario electricity customers through a regulated charge. To help reduce costs for all customers, RRRP and the broadened Delivery charge relief would be funded through the tax base instead of on electricity bills.

Q69. How will enhancing the RRRP through government funding reduce costs?

As a government, we've been focused on ensuring that our electricity system has been fairer for families living in rural areas or with low-incomes.

We recognize that programs, such as the RRRP, are for the common good and that these programs should be delivered to Ontarians through government funding and not through electricity ratepayers.

Q70. When will I see the additional savings on my electricity bill? Will the additional savings be applied retroactively, i.e., to the date I received my initial RRRP rebate?

Legislation is required to implement this program. If passed, the Ministry will work with the Ontario Energy Board (OEB) and affected LDCs to work through implementation details.

Q71. How are you making these changes to the RRRP? Are they a result of legislative changes? Regulation changes?

Changes to the RRRP will be made through amendments to the *Ontario Energy Board Act, 1998* (OEBA). Regulatory amendments will be required to address program details.

Q72. How will industrial customer be affected by this RRRP enhancement?

Industrial customers will not be affected by this RRRP enhancement, though they will experience cost decreases as a result of a reduction in the RRRP regulated charge that all customers currently pay.

The Affordability Fund

Q73. The new Fair Hydro Plan includes two new social and conservation initiatives: On-Reserve First Nations Rate and the Affordability Fund. Can you provide more details about the Affordability Fund?

For those most in need, the low-income Home Assistance Program provides energy efficiency upgrades in homes at no cost to the customer to help reduce future electricity bills.

We recognize that there are other electricity customers who are in need but do not meet the Home Assistance Program eligibility criteria. These electricity customers will be eligible for additional support for energy efficiency measures through the Affordability Fund.

Q74. Who will be eligible to receive funding and how much will the average household receive?

The Affordability Fund provides LDCs with an additional tool to help customers who are not eligible for the existing low-income conservation program. The Fund would provide support for energy efficiency improvements to help customers reduce future electricity bills and avoid future disconnections.

LDCs apply for funding to the Fund administrator, to offer energy efficiency measures to those customers in their service territories that meet the targeted eligibility criteria. Recipients could receive measures ranging from an average of \$3,000 to \$5,000 per customer, at no or minimal cost. For example, measures available in the Home Assistance Program include:

- Energy-saving light bulbs (LEDs); power bars; energy efficient window ACs, refrigerators, freezers, dehumidifiers; low-flow showerheads, hot water blankets, pipe wrap and faucet aerators (in homes with electric water heating);
- Programmable thermostats, weather stripping, insulation (in homes with electric heating); and
- Cold climate air source heat pumps would also be an eligible measure under the Affordability Fund for eligible customers. Heat pumps range in cost from \$7,000 to 13,000.

Q75. How will the Affordability Fund be funded? Where will the money come from?

We will be helping electricity customers by expanding access to energy efficiency measures through an Affordability Fund. The Fund would be established with government funding.

Q76. How are you establishing this new social program? Is it a result of legislative changes? Regulation changes?

Legislative or regulatory changes are not required to establish the LDC Affordability Fund.

The province would enter into an agreement for the program to be delivered through LDCs. LDCs are best positioned to identify and target their customers who would benefit from this program.

The LDC Affordability Fund would provide LDCs an additional tool to help customers who are not eligible for low-income conservation programs.

The conservation programs supported by the Affordability Fund will be funded by government.

On-Reserve First Nations Rate

Q77. What are you doing to reduce electricity bills for First Nations people living on reserves?

We are providing additional support for people who live on First Nations reserves. We are taking a number of actions recommended by the Ontario Energy Board, including:

- Eliminating the delivery charge for all on-reserve First Nations residential customers and removing the monthly service charge for customers of licensed distributors that charge a bundled rate. The Ontario Energy Board estimates this will provide residential customers an average monthly benefit of \$85 (or \$1,020 per year)
- Automatically qualifying on-reserve First Nations residential customers — about 21,500 in total
- Enabling greater information sharing between distributors and band councils to identify all on-reserve First Nations customers.

Q78. Who will be eligible to receive funding and how much will the average household receive?

Eligible customers would receive an average of \$85/month through the On-Reserve First Nations Rate.

Q79. How will the On-Reserve First Nation Rate be funded? Where will the money come from?

We are moving to have the First Nations On-Reserve Rate funded through the tax base, which will reduce regulatory charges on electricity bills for all Ontario ratepayers. We project this will cost about \$20 million in the 2017–18 fiscal year.

Q80. How are you establishing this new social program? Is it a result of legislative changes? Regulation changes?

The proposed legislation offers amendments to the *Ontario Energy Board Act*, required to implement this program. If passed, the government will work with the Ontario Energy Board and affected LDCs on implementation details.

Q81. Can the new On-Reserve First Nations Rate be combined with the OESP? Will a First Nations consumer be eligible for the On-Reserve First Nations Rate and continue

to receive the OESP benefit? Is there a possibility that the combined funding sources could add up to an amount greater than the actual electricity bill?

The OESP enhanced credit is available to all eligible indigenous customers in the province, regardless of where they live. This includes First Nation, Inuit, and Métis customers.

The On-Reserve First Nations Rate applies only to First Nation customers living on a reserve in Ontario.

These programs will be treated as distinct, as they are designed to address different energy cost issues. Thus, customers eligible for both programs will receive credits under both programs.

Market Renewal

Q82. How are you planning on bending the cost curve in the future? If more can be done to reduce rates now, why haven't you already acted?

The government has been working hard to reduce electricity ratepayer costs and will continue to look for efficiencies in the system wherever possible without compromising the reliability of our system.

We have already taken several steps to mitigate system costs, including:

- Renegotiating the Green Energy Investment Agreement (GEIA) in 2013, to reduce contract costs by \$3.7 billion.
- Reducing Feed-in Tariff (FIT) and microFIT prices through annual price reviews, saving ratepayers at least \$1.9 billion.
- Introducing a competitive Large Renewable Procurement (LRP) process to drive down costs approximately \$1.5 billion lower than the 2013 LTEP forecast.
- Suspending the second round of the LRP process and the Energy-from-Waste Standard Offer Program, which is expected to save up to \$3.8 billion in costs.
- Deferring the construction of two new nuclear reactors at Darlington. This was in response to the supply and demand expectations of the 2013 LTEP, avoiding an estimated \$15 billion in new construction costs.
- Maximizing the value of our existing nuclear fleet by starting Bruce refurbishments in 2020, instead of 2016, thus helping to achieve \$1.7 billion in savings relative to the 2013 LTEP forecast and by continuing to operate Pickering up to 2024, pending regulatory approvals, which could save ratepayers as much as \$600 million.

We look forward to working closely with the OEB, OPG and IESO to find even more savings for ratepayers.

Q83. Can you provide details on what the OEB will be doing to help lower future costs?

The OEB has a mandate to regulate the electricity distribution sector in the public interest, ensuring the financial viability of the sector while promoting reliable service to customers at just and reasonable rates.

The OEB, through the Renewed Regulatory Framework for Energy (RRFE), has attempted to move the distribution sector towards a performance/outcomes-based regulatory framework.

While new reporting requirements such as the local distribution company (LDC) performance scorecard are positive developments, RRFE does not tie these system performance expectations to LDC financial performance.

Encouraging shared partnerships on services between utilities will help reduce costs in the back end and encourage further innovation for small to medium sized utilities.

The Ministry of Energy has asked the OEB to look at opportunities to further drive LDC efficiencies and productivity. In parallel, the OEB has been instructed to review business cases behind its own regulatory requirements to reduce “red tape” and eliminate costs that LDCs indicate are creating pressures on operating expenses.

Q84. We have already heard the Minister speak about the need for market renewal. What has been done to move forward these initiatives?

Through the work of the Electricity Market Forum, the Market Surveillance Panel, IESO studies, and stakeholder input, we have been able to identify areas of our electricity system that could improve their efficiency.

The objective of IESO's Market Renewal Project is to implement changes to achieve material efficiencies in the near and longer term with minimal disruption to market participants. The initial findings from the Market Renewal benefits case show potential for cost savings that will be realized by both consumers and market participants.

Cost savings are expected to be achieved through the better utilization of existing assets, greater competition among resources, a reduced need to build new resources, and a more flexible and cost-effective procurement process that will better reflect system needs.

Changes related to IESO's Market Renewal initiatives are estimated to save up to \$300 million per year, starting in 2021.

Municipalities, Schools, and Hospitals

Q85. Is the MUSH sector eligible for the Fair Hydro Plan?

Most municipalities, university, schools and hospitals (MUSH) electricity consumers would not be eligible for the Global Adjustment (GA) refinancing portion of Ontario's Fair Hydro Plan as they are generally too large to be eligible for the Regulated Price Plan (RRP).

MUSH consumers would benefit from shifting the funding for electricity support programs (e.g., Ontario Electricity Support Program) to provincial revenues.

Approximately 2 to 4 per cent as a result of shifting the social support programs to the tax base.

Q86. Do Long-Term Care homes qualify for the benefits from Global Adjustment (GA) refinancing outlined in Ontario's Fair Hydro Plan? They're already eligible for the 8% rebate that took effect on January 1, 2017.

Although Long-Term Care homes are not generally eligible for the Regulated Price Plan (RPP), a policy decision was taken to specifically extend eligibility for the 8% rebate to Long-Term Care homes through the enabling legislation.

Consistent with the 8% rebate, the government intends to include Long-Term Care homes in the GA refinancing proposal.

Advertising

Q87. How much is the government spending on advertising for this latest round of price mitigation initiatives?

We are committed to improving the public's understanding of the energy system.

It is important that the people of Ontario know about the decisions we are making so that they can effectively participate in making decisions on how they use energy.

Advertising is crucial for raising awareness about government programs and to ensure that all Ontarians are aware of how these programs will impact them.

For the placement of advertising regarding the Fair Hydro Plan to date, the Government has committed approximately \$1,100,000.

We continue to assess the need for future public awareness activity.

Q88. Is the Auditor General going to agree with all of this accounting?

We can't presuppose the work of the Auditor General. The government worked hard to assess all fiscal impacts and worked closely with both internal government and external accounting experts.

In crafting the proposed Fair Hydro Act, 2017 the government has consulted broadly, including with:

- Ontario's Energy Agencies
- Experts across government
- External accounting experts
- External legal advisors
- Financial advisors
- Local Distribution Companies

The proposed legislation would deliver on the Government's commitment to fairness, and electricity rates would come down and make life more affordable for families and businesses across the province.

Q89. Was a competitive competition held to select the advertising agency in charge of the campaign?

The advertising agency chosen to help our government raise awareness on these new initiatives is an approved Vendor of Record, with considerable experience in the energy sector.

All the necessary approvals and processes were followed during the selection of the advertising agency.

Our advertising campaign has been, and will continue to be, reviewed and approved by all the proper agencies/parties, including the Auditor General and the Advertising Review Board.

Q90. Why is the government spending money on advertising for this plan when it could be putting those funds toward lowering electricity prices?

We are committed to improving the public's understanding of the energy system.

It is important that the people of Ontario know about the decisions we are making so that they can effectively participate in making decisions on how they use energy.

We have been listening to people in all parts of the province and understand that they need us to do more and that's why we are introducing this plan.

The new Fair Hydro Plan will bring in more savings now through new initiatives that will cut costs directly on your energy bill.

Advertising is crucial for raising awareness about government programs and to ensure that all Ontarians are aware of how these programs will impact them.

For the Affordability Fund, targeted outreach is planned, as opposed to broad marketing, to ensure that support is delivered to customers who need it most.

Another resource available to Ontarians is the Ministry of Energy's emPOWERme website, an online resource dedicated to public education about electricity.

Delivery charges

Q91. Delivery charges have been a big issue for people. Why aren't you eliminating them or lowering them more than you are?

Ontario is making changes to the Rural or Remote Electricity Rate Protection Program to lower delivery charges for about 800,000 rural and remote consumers who currently face some of the highest rates. The legislation, if passed, would eliminate the delivery charge for all

on-reserve First Nations residential consumers, resulting in an average savings of \$85 per month.

Landlords and Tenants

Q92. Landlords will benefit from the new rate relief plan. How will you ensure they pass along these savings to their tenants?

Tenants who pay their own electricity bills are also able to benefit from the programs. The government is looking at ways to ensure that rate relief can be passed along to tenants that do not receive electricity bills.

RPP

Q93. What will the new Regulated Price Plan (RPP) rates be exactly?

The Ontario Energy Board (OEB) has announced changes to the Regulated Price Plan (RPP), which were effective May 1, that include a portion of the savings from Ontario's Fair Hydro Plan. As of May 1, 2017, the time-of-use electricity rates are:

- Off-peak: 7.7 cents/kWh (down from 8.7)
- Mid-peak: 11.3 cents/kWh (down from 13.2)
- On-Peak: 15.7 cents/kWh (down from 18)

For customers on tiered pricing, the rates are:

- Tier 1: 9.1 cents/kWh (down from 10.3)
- Tier 2: 10.6 cents/kWh (down from 12.1)

If the legislation is passed, the OEB would determine the amount of further relief within 15 days of the legislation coming into force.

Q94. This isn't a 25% reduction! Why not, when that was the promise of the Fair Hydro Plan?

The OEB has made its own independent determination to partially reflect the proposed Fair Hydro Plan measures in the new RPP price at this time.

Subsequent to the passage of the Fair Hydro Plan legislation, the OEB has indicated it will review pricing again this summer to determine further reductions.

The current reduction is 17% less for a typical consumer than their bill would have been. That reduction will increase subsequent to the legislation's passage.

Q95. What about customers who are eligible for the Fair Hydro Plan, but don't receive the RPP (like retirement homes and farms) – when will they see decreases?

The proposed legislation, if passed, will enable reductions for these consumers.

Disconnections

Q96. How come only half of Ontario's disconnected hydro customers have been reconnected thus far?

The direction issued by the Ontario Energy Board (OEB) and supported by this government was that reconnecting and restoring full service to customers would happen on a priority basis. LDCs are reporting to the OEB on a weekly basis their activity in reconnecting and restoring full service to their customers, and we expect the OEB will work with LDCs to complete the reconnections in a timely fashion.

Time of Use

Q97. With the delivery charges skyrocketing, why does the Government continue to stand behind TOU Pricing?

With TOU, customers have the ability to better manage their costs by reducing or shifting their consumption to off-peak times when electricity is less expensive to produce. TOU prices give customers incentives to shift consumption away from system peaks, which reduces Ontario's overall peak demand which means we can defer investments and save customers money in the long run.

The OEB is currently undertaking a comprehensive review of the Regulated Price Plan, including analyzing different TOU price structures. One of the key elements of their review is to pilot innovative TOU price structures that would better align with customer's behaviours and better address the system peaks.

For example, the OEB is seeking pilot applications that will test variations to the current TOU structure, such as plans that have a flat rate during the spring and autumn, a plan with only two TOU price periods, and a "Critical Peak Plan" with peak prices for specific hours when the electricity system is stressed, and lower rates during other periods.

Once approved, the pilots will run for a one year period in different cities all over Ontario.

Based on the results of the pilots, the OEB will be exploring the potential for offering a variety of TOU price structures to give customers more choice, allowing them to pick the plan that best suits their lifestyle and manage their electricity costs.

Electricity Rates – Business

Q98. Ontario businesses have repeatedly expressed concerns over the rising costs of electricity, some have even said they will have to close or leave Ontario. How do you respond to this?

Our government continues to make the investments necessary to ensure a clean, reliable and affordable electricity system for all Ontarians. There are measures in place to mitigate industrial electricity prices, including:

- **Industrial Conservation Initiative (ICI);**
 - o **ICI** lowers costs for eligible large electricity consumers that reduce consumption during peak periods. ICI consumers can reduce their electricity rates by up to one third.
 - o To give more businesses the incentive to participate in the ICI, we have lowered the threshold from 3 megawatts (MW) to 1 MW and removed sector restrictions so that more consumers can benefit. Newly eligible consumers that opt-in to ICI will see the impact beginning in July 2017.
 - o We have also expanded ICI to include smaller manufacturers and greenhouses (i.e., NAICs codes commencing “31”, “32”, “33” and “1114”) with average peak demand greater than 500 kW and less than 1 MW. The expansion to 500 kW is effective in July 2017.
- **Northern Industrial Electricity Rate Program (NIERP);**
 - o Participants in the **NIERP** receive a rebate of two cents per kilowatt hour. On average, electricity prices can be reduced by up to 20% through the program.
- **Industrial Accelerator Program (IAP);**
 - o **IAP** assists eligible industrial, commercial and institutional customers that are directly or indirectly connected to the Independent Electricity System Operator (IESO) transmission grid fast-track capital investment in major energy-efficiency projects. Transmission-connected customers with distribution-connected sites can also elect to have these administered through the IAP.
- **saveONenergy for Business conservation programs for commercial and industrial consumers**
 - o The **saveONenergy for Business Conservation Programs** offers a variety of financial incentives to businesses to increase energy efficiency and manage their electricity bills. Incentives are available to a broad range of businesses, including institutional customers such as municipalities, for energy audits, retrofits, process and systems upgrades, and small business lighting.
- **Demand Response Auction.**

- o Annual Demand Response Auctions are held by IESO for demand response capacity. Successful bidders (including residential Demand Response aggregators, large businesses and industry) receive payments to shift their consumption at times when the electricity system is stressed.
- Demand Response (DR)
 - o The IESO holds annual Demand Response auctions which provide payments to successful participants that commit to reducing their consumption when called upon to do so.
 - o These DR auctions are a precursor to the capacity auction that IESO is planning to implement through its market renewal initiative.
 - o Participation in the DR Auction is open to new and existing DR participants in Ontario with peak load greater than 1 MW, including industrial consumers and aggregators.

Broadening the Ownership of Hydro One

Q99. Won't rates rise as a result of your sale of Hydro One? Isn't the interest of the private sector to increase profit by raising rates?

Hydro One does not set its own electricity rates. Rates continue to be set by the independent Ontario Energy Board (OEB).

The OEB is an independent regulator with a mandate to protect the interests of Ontario's electricity consumers. Applications from electricity companies like Hydro One are reviewed by the OEB and the OEB makes the final decision.

The government has passed legislation that enhances the OEB's powers to continue to protect electricity ratepayers with respect to cost, consumer protection and reliability.

Electricity Pricing in other Jurisdictions

Q100. What is the current status of industrial electricity prices in Ontario? How do prices compare to other North American jurisdictions?

Our government continues to ensure a clean, modern and reliable electricity system for all Ontarians.

Prices are increasing because our energy system is being transformed – we are making needed investments to modernize our electricity system. We chose to replace coal-fired generation with cleaner sources of energy, which will benefit our environment and the health of Ontarians.

As we plan for Ontario's electricity needs for the next 20 years, conservation will be the first resource considered, wherever cost effective. Conservation is the cleanest and most cost-effective energy resources, offers customers a way to reduce their electricity bills and reduces the need to build costly new generation, distribution and transmission infrastructure.

Indicative industrial electricity prices in Ontario are currently within five per cent of the United States average as reported by the U.S. Energy Information Administration.

According to 2013 Long-Term Energy Plan (2013 LTEP), the typical industrial electricity price is projected to increase on average by 2.7% per year in the five-year period from 2017 to 2021 inclusive, and by 1.4% per year from 2017 to the end of 2032.

Over the forecast period, the average annual increase in consumers' costs are generally in-line with expected inflation, which averaged about 1.8% over the last ten years (2007-2016).

The National Energy Board's *Energy Futures* 2016 report projects that industrial electricity prices are expected to increase in most provinces through 2032.

Public Sector Salary Disclosure – Energy Agency

101. Ontarians are struggling to pay their Hydro bills and yet you are paying Hydro executives massive salaries. How can you possibly justify this?

The Provincial legislative compensation restraints to control compensation are working. Total salary expenses paid to the top 10 earners in the electricity sector have declined by 30% in 2016 from 2009.

Energy agencies have been demonstrating their on-going commitment to the government's compensation restraints.

All energy agencies have complied with the public sector compensation restraint legislation that froze the compensation structure for non-unionized employees for two years beginning March 24, 2010.

Under Bill 55, the Strong Action for Ontario Act (Budget Measures), executive compensation restraint measures were introduced in March 2012.

In keeping with the government's commitment to manage executive compensation, the *Broader Public Sector Executive Compensation Act, 2014*, was proclaimed into force in March 2015. This legislation enables the government to set compensation frameworks for certain executives in the broader public sector, including OPG, IESO and OEB. The government will be moving forward to develop compensation frameworks for the broader public sector.

Q102. Why are Hydro One employees not captured by the Sunshine List? The opposition parties are demanding that the government add Hydro One employees back onto the list. Will you do this?

Only public sector employees are included on the Sunshine List.

As a publicly traded entity, Hydro One is no longer required to report salaries earned after December 31, 2014 under the PSSDA. However, similar to the Ontario Securities Commission requirements, Hydro One has to disclose the total compensation levels of the CEO, CFO and three other highest paid executives of the corporation each year.

As an OBCA company subject to Canadian Securities law, Hydro One continues to comply with rigorous governance requirements that include:

- Disclosure of board approved annual financial statements along with quarterly updates
- CEO and CFO Certifications and Associated Controls certifying that there are no misrepresentations in the annual or quarterly materials
- Shareholders' meetings requirements and rules
- Disclosure requirements with respect to management circulars (including information about senior management, such as share ownership, any indebtedness to the company and any interest in material transactions) as well as compensation circulars (executive compensation disclosures including shares awarded, perks and incentives)

**MOF - FAO Report on the Fair Hydro Plan
May 23, 2017**

MEDIA KEY MESSAGES

- The Fair Hydro Plan, which includes the Ontario Rebate for Electricity Consumers equivalent to the provincial 8 per cent portion of the HST, will lower electricity bills by 25 per cent on average for residential consumers in the province starting this summer — the single-largest reduction in Ontario's history.
- The Financial Accountability Office's (FAO) analysis confirms that people living in Ontario would receive significant relief under the Fair Hydro Plan.
- Under the proposed legislation, programs such as the Ontario Electricity Support Program and the Rural or Remote Rate Protection Program would be government-funded going forward and not just for a few years. This would mean more savings for ratepayers on an on-going basis.
- About 500,000 small businesses and farms will also benefit from the initiative.
- We are also proposing to lower energy costs by expanding access to natural gas to communities that are currently underserved, including rural, northern Ontario and First Nation communities.
- As part of the Fair Hydro Plan, we are helping to relieve the burden of financing system improvements and funding key electricity support social programs to allocate costs more fairly and equitably.
- Reducing electricity costs is part of Ontario's plan to create jobs, grow our economy and help people in their everyday lives.

MEDIA QAs

Q: The Financial Accountability Office (FAO) estimates that the FHP will cost the Province approximately \$45 billion over 29 years while providing overall savings to electricity ratepayers of \$24 billion resulting in a net cost of \$21 billion. Why is the Government doing this if the costs outweigh the benefits?

The burden of financing improvements to Ontario's electricity infrastructure and funding key programs has unfairly fallen on the shoulders of today's ratepayers.

That is why our Fair Hydro Plan is committed to reduce current high electricity bills by 25 per cent while shifting costs to the future to more fairly match the benefits and costs of these investments.

Recognizing that the electricity infrastructure that has been built will last for decades to come, the Province is proposing to refinance those capital investments to ensure that system costs are more equitably distributed over time.

**MOF - FAO Report on the Fair Hydro Plan
May 23, 2017**

The plan significantly reduces rates today and ensures fairness and predictability for tomorrow.

Q. Why have electricity rates gone up in the first place?

Electricity rates have risen for two key reasons:

1. Years of under-investment in the electricity system, which meant more than \$50 billion has been invested since 2003 to ensure the system is cleaner and more reliable.
2. The decision to eliminate Ontario's use of coal and produce cleaner and renewable power.

The burden of financing these system improvements and funding key electricity support social programs has unfairly fallen on today's ratepayers.

As part of the Fair Hydro Plan, we are helping to relieve that burden and allocating costs more fairly and equitably.

Q. How are you going to help share the cost more fairly?

The electricity infrastructure that has been built will last for decades to come.

We are refinancing the cost of the contracts for those capital investments so that system costs are more equitably distributed over time.

In addition, a number of important programs, such as the Ontario Electricity Support Program and Rural or Remote Electricity Rate Protection, will now be funded by the government instead of ratepayers.

Q. How can Ontario afford the Fair Hydro Plan?

With a growing economy, responsible fiscal management and balanced budgets projected in 2017-18 and the following two years, we are able to take measures to help ease electricity cost pressures for people in Ontario.

This will not mean an increase in taxes.

We'll do this by changing the way electricity costs are recovered and moving funding for assistance programs off of electricity bills.

[If pressed]

This Fair Hydro Plan includes changing some funding sources to be government-funded, which will cost the government \$2.5 billion over the first three years, and recovering other costs more fairly from ratepayers over a longer time period.

**MOF - FAO Report on the Fair Hydro Plan
May 23, 2017**

Q. Will you raise taxes to pay for the relief?

The Fair Hydro Plan will not mean an increase in taxes or create a need for new taxes.

Q. Aren't you just making the taxpayer subsidize the ratepayer? And won't that be even more expensive once interest rates are taken into account?

We are dedicated to reducing electricity costs wherever possible, while maintaining reliability for all consumers.

The Fair Hydro Plan would deliver significant savings for eligible electricity consumers.

Q. Why not make changes to directly benefit those who really need it?

With the Fair Hydro Plan, those with eligible low incomes and those living in eligible rural or remote communities would benefit from additional reductions to their electricity bills.

Ontario has a number of programs in place to help low-to-moderate income individuals and families with energy costs.

Programs include the Ontario Energy and Property Tax Credit, the Ontario Electricity Support Program, the Ontario Sales Tax Credit and the Northern Ontario Energy Credit.

We are also reducing costs for eligible rural or remote customers by expanding eligibility and providing additional funding to the Rural or Remote Electricity Rate Protection program.

The removal of the debt retirement charge has been saving typical residential users about \$70 every year since January 1, 2016.

Q. How much is this going to add to your debt?

The intention is that refinancing the cost of the contracts for the electricity generation infrastructure investments (i.e. global adjustment deferral and refinancing) will leave net debt unaffected.

[If pressed]

This Fair Hydro plan includes changing some funding sources to be government-funded, which will cost the government up to \$2.5 billion over the first three years,

Q. Does third party accounting opinion support the Global Adjustment deferral plan?

Yes. The proposed legislation was reviewed by impacted government agencies involved and their external advisors. Their preliminary advice conditionally supports the accounting structure.

[If pressed]

Input was provided by the Independent Electricity Sector Operator and Ontario Power Generation as well as their external accounting advisors.

MOF - FAO Report on the Fair Hydro Plan
May 23, 2017

Many specifics remain outstanding and will only be addressed through future regulations and commercial agreements, which is why the accounting firms can only conditionally support the accounting structure.

GLOBAL ADJUSTMENT SMOOTHING PROPOSAL

ISSUE: How is the government refinancing the Global Adjustment?

KEY MESSAGES:

- From 2003, Ontario invested more than \$50 billion in the electricity system, to ensure the system is clean and reliable. The costs of the generation investments are funded in part through the Global Adjustment (GA).
- The majority of the generation costs are recovered over their 20-year contract period, while many of the assets are expected to be able to generate electricity for a longer period.
- To relieve the current burden on ratepayers and allocate costs more fairly over the period of expected benefit to ratepayers, a portion of the GA is being refinanced.
- Refinancing the GA would provide significant and immediate rate relief to eligible ratepayers by spreading the cost of electricity investments over a 30-year period to better reflect the expected lifecycle of the infrastructure that has been built.
- In the early years, a portion of the costs covered by the GA would be refinanced to reduce pressure on today's electricity ratepayers.
- In later years, the cost of refinancing would be recovered from ratepayers.

- Under current forecasts, the immediate reduction in the GA would be about \$2.5 billion per year on average over the first 10 years.
- The government introduced legislation that would, if passed, enable the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG) to work together to refinance the GA over a longer period of time. The proposed legislation would also outline the role for the Ontario Energy Board (OEB), as it relates to the financing proposal.
- Any further questions related to the GA refinancing should be directed to my colleague, the Minister of Energy.

IF ASKED ABOUT ACCOUNTING METHODS FOR GLOBAL ADJUSTMENT:

- Under the proposed structure, the Province's net debt and annual surplus/deficit is not expected to be negatively impacted since all costs are expected to be recovered through future rates.
- However, there is still much to be done in terms of working out the remaining details through regulations and commercial agreements.
- The fiscal impact to the Province will only be known once those details are finalized.

- The Ministry of Finance continues to work closely with Treasury Board Secretariat, the Ministry of Energy, OPG, the IESO and external advisors to address the outstanding accounting related considerations which will be key to managing the fiscal impact of the GA refinancing.
- The Auditor General has also been briefed on the proposed structure of the GA refinancing structure and will be advised of the government's proposed accounting treatment once the necessary details are available.

IF ASKED ABOUT STRUCTURAL DEFICIT:

- Any questions on this issue should be directed to my colleague, the Minister of Finance.

CURRENT STATUS:

- The Global Adjustment (GA) smoothing proposal was announced March 2, 2017, as a part of the proposed Fair Hydro Plan.
- The government introduced legislation on May 11, 2017 that would, if passed, enable the Independent Electricity System Operator (IESO) and Ontario Power Generation (OPG) to work together to refinance the GA over a longer period of time. The legislation would also outline the role for the Ontario Energy Board (OEB).

BACKGROUND:

- The Ministry of Finance (MOF) and Ontario Financing Authority (OFA) are the lead on questions relating to debt financing for the Global Adjustment (GA).
- The global adjustment component of the electricity bill covers part of the cost of the electricity commodity.
- The global adjustment is set monthly to reflect:
 - o The differences between the wholesale market price for electricity, known as Hourly Ontario Energy Price (HOEP) and:

- Regulated rates for Ontario Power Generation's nuclear and hydroelectric generating stations, and
- Payments for contracted rates paid to a number of generators across the province that have built or refurbished and operate electricity generation infrastructure such as gas-fired and renewable facilities (e.g., hydro, wind, solar) and nuclear
 - o The cost of delivering conservation programs
- The GA varies from month to month, responding to changes in the HOEP compared to contract prices. Generally speaking, when the HOEP is lower, the GA is higher to cover additional costs for the items referenced above. The GA rate is also impacted when new projects come into service, contract payments take effect or as a result of changes in Ontario electricity demand.

Fair Hydro Plan and Global Adjustment

- To relieve the current burden on ratepayers and allocate costs more fairly, a portion of the GA is proposed to be refinanced under the Fair Hydro Plan.
- Refinancing the GA would provide significant and immediate rate relief by spreading the cost of electricity investments over 30 years to better reflect the expected lifecycle of infrastructure that has been built.
- In the early years, a portion of the costs covered by the GA would be refinanced to reduce pressure on today's electricity ratepayers
- In later years, the cost of refinancing would be recovered from ratepayers.
- Under current forecasts, the immediate reduction in the GA would be about \$2.5 billion per year on average over the first 10 years.

RECENT MEDIA COVERAGE:

- May 12, 2017 – There is widespread coverage of allegedly leaked government documents that show the 25% cut to hydro rates now could mean high electricity bills in the long-term. The Toronto Star (A1) and Globe & Mail (A4) report briefing materials show the average Toronto Hydro customer would save almost \$2,500 through to 2025, but bills would increase an extra \$4,800 over the following 22 years. The Globe says Ontarians would see a charge of about \$20 on monthly bills to repay the almost \$28-billion in debt accumulated to lower rates for almost a decade. **Tone negative.**
- May 11, 2017 – Toronto Sun reports "Ontarians are in for a hydro shock".
- May 11, 2017 – CBC reports an allegedly leaked cabinet document reveals hydro bills will increase over the next decade and surpass \$200/month on average in 2028.
- May 11, 2017 – Toronto Star reports the average hydro bill will jump almost \$10/month in 2022 and soar to \$195 by 2027. The article quotes alleged leaked cabinet documents obtained by the PC's.

Originated by: Erin Ovenden, Communications Branch, 416-326-7727, May 8, 2017

Updated by: Bryant Sullivan, Communications Branch, 416-325-1378, May 12, 2017

Approved by:	Name:	Date Approved:
Manager		
Director	Nadine Petsche	May 10, 2017
ADM	Cindy Veinot	May 10, 2017
Associate DM	Karen Hughes	May 10, 2017
Legal (if required)		
Communications Branch	Bryant Sullivan	May 12, 2017

From: [Schlaepfer, Martin \(ENERGY\)](#)
To: [Anna Strathy](#)
Subject: FW: Final AG Report Materials
Date: Tuesday, October 17, 2017 11:55:21 AM
Attachments: [FINAL OFHP - Media Briefing.pdf](#)
[Fact Sheet - Oct. 17 - FINAL FR.PDF](#)
[Fact Sheet - Oct. 17 - FINAL.PDF](#)
[QA_AG Report OFHP_Technical Briefing_Oct16_Clean_400.docx](#)

Sorry, I forgot to include you.

From: Schlaepfer, Martin (ENERGY)
Sent: October 17, 2017 11:17 AM
To: Kwamena, Boafoa (CAB) <Boafoa.Kwamena@ontario.ca>; MacIntyre, Kyle (TBS) <Kyle.MacIntyre@ontario.ca>; McLean, David (MOF) <David.McLean@ontario.ca>; Farrow, Alicia (CAB) <Alicia.Farrow@ontario.ca>; Ue, Allison (TBS) <Allison.Ue@ontario.ca>; Laughton, Patrick (TBS) <Patrick.Laughton@ontario.ca>; Hosick, Sarah (TBS) <Sarah.Hosick@ontario.ca>; Cox, Hilary (ENERGY) <Hilary.Cox@ontario.ca>
Cc: Bromm, William (CAB) <William.Bromm2@ontario.ca>
Subject: Final AG Report Materials

Hi everyone,

Attached are the final materials in pdf, including the French Fact Sheet. QAs also attached in word. A Deloitte handout should be arriving momentarily.

Materials remain unchanged from the previous version. Just sharing so everyone has all in one place.

Thanks,
Martin

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Ontario's Fair Hydro Plan – Status Update

Technical Briefing

October 17, 2017

Ontario's Electricity System

- Ontario's electricity system is a \$20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries – with costs transparently recovered.
- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It approves rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.
- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it. It also manages contracts with non-regulated generators. In addition, the IESO plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.
- Ontario Power Generation (OPG) is wholly-owned by the Province of Ontario and produces almost half of the electricity used in Ontario. OPG owns and operates: two nuclear stations, 66 hydroelectric stations, two biomass stations and one thermal station.

Ontario's Fair Hydro Plan

- Ontario's Fair Hydro Plan (OFHP) is delivering rate relief to residential consumers, farms, most small businesses, long-term care homes and condominiums. This includes the 8% rebate equivalent to the provincial portion of the HST that came into effect on January 1, 2017.
- OFHP is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.
- The government, OPG, IESO, OEB, key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.
- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
 - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
 - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
 - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
 - July 1, 2017: The full 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.
- The new and enhanced existing electricity social programs include:
 - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
 - Expanded Ontario Electricity Support Program;
 - New First Nations On-Reserve Delivery Credit; and
 - New Affordability Fund.
- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province (\$M)	16-17	17-18	18-19	19-20	20-21	5-Year Total
RRRP Enhancements	-	459	472	484	497	1,912
Ontario Electricity Support Program	-	186	261	325	375	1,147
On-Reserve First Nation Delivery Credit	-	20	20	20	20	80
Affordability Fund	200	-	-	-	-	200
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	300	883	860	861	871	3,775
Total Fiscal Cost to the Province	500	1,548	1,613	1,690	1,763	7,114

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- 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 are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.
- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, 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.
- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.
- The GA refinancing program ensures that costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.
- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (e.g. Navigant, KPMG, EY and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March 2017 announcement of Ontario's Fair Hydro Plan (OFHP), the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
 - Current government estimates forecast the peak debt over the thirty year life of OFHP will be below \$20 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The revised debt estimates are the result of the following factors:
 - The IESO updated its long-term cost projections for the electricity system and residential bills;
 - The OEB provided “actual data” with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
 - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).
- It should be noted that 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 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.

GA Refinancing – Role of Ontario Power Generation (OPG)

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
 - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
 - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.
- OPG currently manages approximately \$20 billion nuclear funds and as an entity regulated by the OEB, OPG also has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

GA Refinancing – Role of the Independent Electricity System Operator (IESO)

- The IESO administers \$17 billion of the \$20 billion annual electricity system, settling transactions between generators and consumers of electricity.
 - Market accounts and liabilities are included on IESO financial statements to provide increased transparency around the value of transactions that flow through the market.
 - The IESO is a corporation established pursuant to Part II of the Electricity Act, 1998, and prepares its financial statements in accordance with Public Sector Accounting Standards (PSAS).
- Under Ontario's Fair Hydro Plan (OFHP), IESO continues to invoice eligible customers – but not collect – the full amount of Global Adjustment (GA) every month.
- The IESO's right to recover these costs from future ratepayers, constitutes a regulatory asset. The regulatory asset, is transferred to the Fair Hydro Plan Trust.
- The IESO will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
 - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (Electricity Act) and the Ontario Energy Board Act (OEBA).

GA Refinancing – Accounting Considerations

- 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.
- PSAS is 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 in this scenario.
- Section PS 1150.07 from the Public Sector Accounting Handbook:
 - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.*
- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- OFHP 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.

Questions?

Rapport spécial de la vérificatrice générale sur le Plan ontarien pour des frais d'électricité équitables

17 octobre 2017

Le rapport spécial du Bureau de la vérificatrice générale est axé sur le cadre financier et comptable du Plan ontarien pour des frais d'électricité équitables, qui procure la plus importante réduction des tarifs d'électricité de l'histoire de la province en réduisant la facture d'électricité des consommateurs résidentiels de 25 % en moyenne, tout en faisant en sorte que les augmentations ne dépassent pas le taux d'inflation pendant quatre ans. Pas moins d'un demi-million de petites entreprises et d'exploitations agricoles profitent également de cette réduction.

Refinancement du rajustement global (RG)

- Pour alléger le fardeau qui pèse actuellement sur les contribuables et partager les coûts plus équitablement, le Plan ontarien pour des frais d'électricité équitables prévoit le refinancement d'une partie du rajustement global (RG), ce qui permettra de recouvrer certains coûts associés aux investissements effectués récemment dans le réseau d'électricité.
- Le refinancement du RG aura pour effet de réduire immédiatement et considérablement les tarifs en répartissant le coût des investissements dans le réseau d'électricité au cours de la durée utile prévue de l'infrastructure de production qui a été construite.
- Dans le cadre de l'élaboration de la politique de refinancement du RG, le gouvernement a tenu compte de diverses options de mise en œuvre et consulté des experts indépendants des secteurs des services juridiques, de la comptabilité, des finances et de l'énergie afin d'obtenir des conseils et veiller à l'exécution d'un processus de diligence raisonnable.
- La structure de refinancement du RG respecte efficacement les objectifs du programme de refinancement et permet de veiller à ce que les charges reportées soient imputées à l'assiette tarifaire, représentant les bénéficiaires du réseau d'électricité, et non à l'assiette fiscale.

Cadre comptable du Plan ontarien pour des frais d'électricité équitables

- Les états financiers du gouvernement sont établis conformément aux normes comptables pour le secteur public, et l'on continuera de suivre ces normes pour ce qui est des transactions découlant du Plan ontarien pour des frais d'électricité équitables en 2017-2018 et lors des exercices futurs.
- Dans le cadre de l'élaboration de la structure de refinancement du RG, le gouvernement et ses organismes ont consulté plusieurs conseillers indépendants (p. ex., KPMG, EY, Deloitte) au sujet de l'application des normes comptables. Il s'agit d'une mesure normale pour un gouvernement dans le cas des transactions complexes.
- La Société indépendante d'exploitation du réseau d'électricité (SIERE) reflètera l'incidence du refinancement du RG par la comptabilisation des activités à tarifs réglementés :

- La comptabilisation des activités à tarifs réglementés reflète davantage la réalité économique des opérations de la SIERE et accroît la pertinence et la transparence de son information financière, en plus d'améliorer le processus de reddition de comptes connexe;
- La comptabilisation des activités à tarifs réglementés est une méthode bien connue dans le secteur de l'électricité. D'autres organisations canadiennes du secteur de l'électricité utilisent cette méthode, soit Ontario Power Generation, Toronto Hydro et Fortis Inc.;
- La reconnaissance des actifs réglementaires fait en sorte que la SIERE est alignée sur six autres exploitants de réseau indépendants d'Amérique du Nord – AESO, en Alberta, ISO, en Nouvelle-Angleterre, NYISO, à New York, MISO, dans le Midwest des États-Unis, PJM, dans l'est des États-Unis, et ERCOT, au Texas.
- Les normes comptables pour le secteur public ne font pas état de la comptabilisation des activités à tarifs réglementés :
 - On y reconnaît qu'on ne fournit aucune ligne directrice sur les transactions possibles et on y indique qu'il est nécessaire de se reporter à cette fin à d'autres sources conformes au cadre de celles-ci;
 - La SIERE a consulté les normes US GAAP, qui contiennent les lignes directrices les plus complètes sur la comptabilisation des activités à tarifs réglementés et constituent la source la plus appropriée à consulter dans ce cas-ci.
- La firme KPMG a publié une opinion claire dans sa vérification des états financiers de la SIERE du 31 décembre 2016, dans lesquels elle reconnaît les actifs liés à des activités à tarifs réglementés et les comptes de marché.
- Deloitte a également été consulté et a confirmé qu'une entité utilisant les normes comptables pour le secteur public peut avoir des actifs réglementaires si elle est soumise à une réglementation tarifaire. La SIERE est assujettie à la réglementation tarifaire de la Commission de l'énergie de l'Ontario (CEO) en vertu de la *Loi de 1998 sur l'électricité* et de la *Loi sur la Commission de l'énergie de l'Ontario*.

Ontario Power Generation en tant que gestionnaire des services financiers

- Ontario Power Generation (OPG) a été désigné gestionnaire des services financiers responsable d'élaborer les plans de financement et d'agir en tant qu'entité de financement (c.-à-d. comme Fonds du Plan pour des frais d'électricité équitables) responsable de la gestion des obligations liées au refinancement du RG.
- OPG possède le financement et l'expertise commerciale nécessaires pour aider au refinancement du RG et veillera à ce que cela soit réalisé de manière efficace et rentable.
- OPG gère actuellement environ 20 milliards de dollars de fonds liés au nucléaire et en tant qu'entité réglementée par la Commission de l'énergie de l'Ontario (CEO), OPG possède une vaste expérience des comptes de report et d'écart réglementaires.
- OPG a également développé de solides relations avec les investisseurs et dispose des appuis nécessaires au sein du secteur financier structuré qui serait le marché cible pour financer le Plan ontarien pour des frais d'électricité équitables.
 - Par exemple, le financement du projet Lower Mattagami a attiré une vaste clientèle composée d'environ 80 investisseurs institutionnels, y compris d'importants investisseurs sur le marché canadien des obligations finançant les services publics d'électricité.
- De plus, la structure du Plan ontarien pour des frais d'électricité équitables incite OPG, en tant que gestionnaire des services financiers, à minimiser le coût d'emprunt en basant une partie de ses frais de gestion sur sa capacité à obtenir des taux d'intérêt inférieurs aux taux d'intérêt prévus.

- OPG est actuellement en discussions préliminaires avec des agences de notation et prévoit entrer sur le marché en novembre 2017.

Rapport du Bureau de la responsabilité financière sur les coûts du Plan ontarien pour des frais d'électricité équitables

- Le rapport du Bureau de la responsabilité financière s'appuyait sur les estimations initiales du ministère de l'Énergie de mars 2017. L'analyse subséquente effectuée par le ministère a permis d'affiner certaines variables, y compris le coût d'emprunt et les prévisions des coûts du réseau électrique.
- Les estimations d'emprunt total imputé au Plan ontarien pour des frais d'électricité équitables sur une période de trente ans ont été considérablement révisées par le gouvernement depuis que le Bureau de la responsabilité financière a publié son rapport en mai 2017. Les coûts d'emprunt devraient maintenant être nettement inférieurs aux estimations initiales.
- Les estimations actuelles du gouvernement prévoient qu'à son point culminant, sur une période de trente ans, la dette imputable au Plan ontarien pour des frais d'électricité équitables sera inférieure à 20 milliards de dollars. L'estimation préliminaire de mars 2017 était d'environ 28 milliards de dollars.
- Le rapport du Bureau de la responsabilité financière conclut en disant que « les estimations du Bureau de la responsabilité financière sont sujettes à de nombreuses hypothèses et incertitudes... Les répercussions fiscales peuvent être nettement différentes des prévisions du Bureau. »
- OPG est à mettre en place le processus pour recueillir les fonds nécessaires pour financer ces coûts reportés et, bien que les coûts d'emprunt totaux ne seront pas connus avant la fin de la transaction, les intérêts accumulés devraient être nettement inférieurs aux estimations prévues dans le rapport du Bureau de la responsabilité financière.
- Le gouvernement continuera également d'identifier et de mettre en œuvre des initiatives pour réduire les coûts du réseau électrique, et ainsi réduire le coût du programme de refinancement du RG. De plus amples informations seront publiées dans le Plan énergétique à long terme de 2017 (PELT de 2017), qui sera publié le 26 octobre 2017.

Auditor General's Special Report on the Ontario Fair Hydro Plan

October 17, 2017

The special report from the Office of the Auditor General (OAG) focuses on the financial and accounting framework of Ontario's Fair Hydro Plan (OFHP), which is delivering the single largest reduction in electricity rates in the province's history by lowering electricity bills by an average of 25% for residential consumers, and holding increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting.

Refinancing the Global Adjustment (GA)

- To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the GA, which recovers costs associated with recent investments in the electricity system.
- Refinancing the GA provides significant and immediate rate relief by spreading the cost of electricity system investments over the expected useful life of the generation assets that have been built.
- In developing the policy to refinance the 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.
- The GA refinancing design 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's Fair Hydro Plan Accounting

- 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 the development of GA refinancing, the government and its agencies consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- The Independent Electricity System Operator (IESO) will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and

- The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- PSAS is 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
 - The IESO consulted US GAAP, which has the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the Ontario Energy Board (OEB) in accordance with the Electricity Act and the Ontario Energy Board Act.

Ontario Power Generation as Financial Services Manager

- Ontario Power Generation (OPG) has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
- OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.
- OPG currently manages approximately \$20 billion in nuclear funds and as an entity regulated by the Ontario Energy Board (OEB), OPG has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.
- Further, the structure of the OFHP incents OPG, in its role as FSM, to keep the cost of borrowing to a minimum by basing a portion of its management fees on its ability to achieve lower than forecast interest rates.
- OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.

Financial Accountability Office's Report on the Costs of the Ontario's Fair Hydro Plan

- The Financial Accountability Office's (FAO) report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry 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 FAO released its report in May 2017. The 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 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The FAO report concludes by saying “the FAO’s estimates are subject to many assumptions and uncertainties ... Fiscal impact may differ significantly from the FAO’s estimates.”
- OPG is now 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 FAO.
- The government will also 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.

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 Auditor 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.

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 billion¹⁵ to \$18.5 billion¹⁶. 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 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.

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 billion²². The preliminary estimate from March 2017 was about \$28 billion²³.

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.”

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 billion²⁴ to \$18.5 billion²⁵. 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 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.

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 billion²⁹. The preliminary estimate from March 2017 was about \$28 billion³⁰.

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 billion³¹ to \$18.5 billion³². The higher March 2017 estimate was used by the FAO in its May 2017 report.

²⁴ Ministry of Energy

²⁵ Ministry of Energy

²⁶ Ministry of Energy

²⁷ Ministry of Energy

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

If pressed on interest costs:

The Ministry estimates of total interest cost also decreased from \$25 billion³³ to \$18 billion³⁴.

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 Auditor General's (AG) 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 of Energy 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 of Energy conducted a search consistent with the 40 plus search terms provided to the Auditor General (AG). In order to manage the approximately 2.2 million records that resulted from the search of 81 custodians, the Ministry 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 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 in 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.

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.

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.

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 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

From: [Anna Strathy](#)
To: [Bonnie Lemcke](#)
Subject: FW: Final OFHP AG Products
Date: Tuesday, October 17, 2017 12:15:28 PM
Attachments: [Fact Sheet - Oct. 17 - FINAL.pdf](#)
[FINAL OFHP - Media Briefing.pdf](#)

FYI sounds like no press release.

From: Lone, Dianne (MOF) [mailto:Dianne.Lone@ontario.ca]
Sent: Tuesday, October 17, 2017 11:29 AM
To: Anna Strathy <Anna.Strathy@ofina.on.ca>
Subject: FW: Final OFHP AG Products

Here are finals from Energy.

From: Barbaro, Rachel (ENERGY)
Sent: October 17, 2017 11:18 AM
To: Lone, Dianne (MOF)
Cc: Evans, Karen (ENERGY)
Subject: Final OFHP AG Products

Hi Dianne, finals attached. Pls note, nothing is going on newsroom or going out to media. MO will use fact sheet reactively.

Thanks
Rachel

Rachel Barbaro
Manager, Strategic Communications
Ministry of Energy, Communications Branch
416 212 4634

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October 17, 2017

The special report from the Office of the Auditor General (OAG) focuses on the financial and accounting framework of Ontario's Fair Hydro Plan (OFHP), which is delivering the single largest reduction in electricity rates in the province's history by lowering electricity bills by an average of 25% for residential consumers, and holding increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting.

Refinancing the Global Adjustment (GA)

- To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the GA, which recovers costs associated with recent investments in the electricity system.
- Refinancing the GA provides significant and immediate rate relief by spreading the cost of electricity system investments over the expected useful life of the generation assets that have been built.
- In developing the policy to refinance the 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.
- The GA refinancing design 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's Fair Hydro Plan Accounting

- 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 the development of GA refinancing, the government and its agencies consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- The Independent Electricity System Operator (IESO) will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and

- The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- PSAS is 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
 - The IESO consulted US GAAP, which has the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the Ontario Energy Board (OEB) in accordance with the Electricity Act and the Ontario Energy Board Act.

Ontario Power Generation as Financial Services Manager

- Ontario Power Generation (OPG) has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
- OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.
- OPG currently manages approximately \$20 billion in nuclear funds and as an entity regulated by the Ontario Energy Board (OEB), OPG has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.
- Further, the structure of the OFHP incents OPG, in its role as FSM, to keep the cost of borrowing to a minimum by basing a portion of its management fees on its ability to achieve lower than forecast interest rates.
- OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.

Financial Accountability Office's Report on the Costs of the Ontario's Fair Hydro Plan

- The Financial Accountability Office's (FAO) report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry 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 FAO released its report in May 2017. The 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 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The FAO report concludes by saying “the FAO’s estimates are subject to many assumptions and uncertainties ... Fiscal impact may differ significantly from the FAO’s estimates.”
- OPG is now 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 FAO.
- The government will also 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.

Ontario's Fair Hydro Plan – Status Update

Technical Briefing

October 17, 2017

Ontario's Electricity System

- Ontario's electricity system is a \$20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries – with costs transparently recovered.
- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It approves rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.
- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it. It also manages contracts with non-regulated generators. In addition, the IESO plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.
- Ontario Power Generation (OPG) is wholly-owned by the Province of Ontario and produces almost half of the electricity used in Ontario. OPG owns and operates: two nuclear stations, 66 hydroelectric stations, two biomass stations and one thermal station.

Ontario's Fair Hydro Plan

- Ontario's Fair Hydro Plan (OFHP) is delivering rate relief to residential consumers, farms, most small businesses, long-term care homes and condominiums. This includes the 8% rebate equivalent to the provincial portion of the HST that came into effect on January 1, 2017.
- OFHP is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.
- The government, OPG, IESO, OEB, key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.
- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
 - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
 - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
 - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
 - July 1, 2017: The full 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.
- The new and enhanced existing electricity social programs include:
 - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
 - Expanded Ontario Electricity Support Program;
 - New First Nations On-Reserve Delivery Credit; and
 - New Affordability Fund.
- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province (\$M)	16-17	17-18	18-19	19-20	20-21	5-Year Total
RRRP Enhancements	-	459	472	484	497	1,912
Ontario Electricity Support Program	-	186	261	325	375	1,147
On-Reserve First Nation Delivery Credit	-	20	20	20	20	80
Affordability Fund	200	-	-	-	-	200
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	300	883	860	861	871	3,775
Total Fiscal Cost to the Province	500	1,548	1,613	1,690	1,763	7,114

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- 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 are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.
- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, 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.
- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.
- The GA refinancing program ensures that costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.
- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (e.g. Navigant, KPMG, EY and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March 2017 announcement of Ontario's Fair Hydro Plan (OFHP), the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
 - Current government estimates forecast the peak debt over the thirty year life of OFHP will be below \$20 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The revised debt estimates are the result of the following factors:
 - The IESO updated its long-term cost projections for the electricity system and residential bills;
 - The OEB provided “actual data” with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
 - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).
- It should be noted that 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 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.

GA Refinancing – Role of Ontario Power Generation (OPG)

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
 - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
 - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.
- OPG currently manages approximately \$20 billion nuclear funds and as an entity regulated by the OEB, OPG also has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

GA Refinancing – Role of the Independent Electricity System Operator (IESO)

- The IESO administers \$17 billion of the \$20 billion annual electricity system, settling transactions between generators and consumers of electricity.
 - Market accounts and liabilities are included on IESO financial statements to provide increased transparency around the value of transactions that flow through the market.
 - The IESO is a corporation established pursuant to Part II of the Electricity Act, 1998, and prepares its financial statements in accordance with Public Sector Accounting Standards (PSAS).
- Under Ontario's Fair Hydro Plan (OFHP), IESO continues to invoice eligible customers – but not collect – the full amount of Global Adjustment (GA) every month.
- The IESO's right to recover these costs from future ratepayers, constitutes a regulatory asset. The regulatory asset, is transferred to the Fair Hydro Plan Trust.
- The IESO will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
 - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (Electricity Act) and the Ontario Energy Board Act (OEBA).

GA Refinancing – Accounting Considerations

- 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.
- PSAS is silent on the use of regulated accounting:
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 - US GAAP, with the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.
- Section PS 1150.07 from the Public Sector Accounting Handbook:
 - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.*
- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- OFHP 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.

Questions?

From: [Lone, Dianne \(MOF\)](#)
To: [Anna Strathy](#)
Subject: FW: Final OFHP AG Products
Date: Tuesday, October 17, 2017 11:29:02 AM
Attachments: [Fact Sheet - Oct. 17 - FINAL.pdf](#)
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From: Barbaro, Rachel (ENERGY)
Sent: October 17, 2017 11:18 AM
To: Lone, Dianne (MOF)
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Subject: Final OFHP AG Products

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 - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
 - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
 - July 1, 2017: The full 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.
- The new and enhanced existing electricity social programs include:
 - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
 - Expanded Ontario Electricity Support Program;
 - New First Nations On-Reserve Delivery Credit; and
 - New Affordability Fund.
- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province (\$M)	16-17	17-18	18-19	19-20	20-21	5-Year Total
RRRP Enhancements	-	459	472	484	497	1,912
Ontario Electricity Support Program	-	186	261	325	375	1,147
On-Reserve First Nation Delivery Credit	-	20	20	20	20	80
Affordability Fund	200	-	-	-	-	200
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	300	883	860	861	871	3,775
Total Fiscal Cost to the Province	500	1,548	1,613	1,690	1,763	7,114

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- 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 are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.
- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, 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.
- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.
- The GA refinancing program ensures that costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.
- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (e.g. Navigant, KPMG, EY and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March 2017 announcement of Ontario's Fair Hydro Plan (OFHP), the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
 - Current government estimates forecast the peak debt over the thirty year life of OFHP will be below \$20 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The revised debt estimates are the result of the following factors:
 - The IESO updated its long-term cost projections for the electricity system and residential bills;
 - The OEB provided “actual data” with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
 - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).
- It should be noted that 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 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.

GA Refinancing – Role of Ontario Power Generation (OPG)

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
 - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
 - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.
- OPG currently manages approximately \$20 billion nuclear funds and as an entity regulated by the OEB, OPG also has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

GA Refinancing – Role of the Independent Electricity System Operator (IESO)

- The IESO administers \$17 billion of the \$20 billion annual electricity system, settling transactions between generators and consumers of electricity.
 - Market accounts and liabilities are included on IESO financial statements to provide increased transparency around the value of transactions that flow through the market.
 - The IESO is a corporation established pursuant to Part II of the Electricity Act, 1998, and prepares its financial statements in accordance with Public Sector Accounting Standards (PSAS).
- Under Ontario's Fair Hydro Plan (OFHP), IESO continues to invoice eligible customers – but not collect – the full amount of Global Adjustment (GA) every month.
- The IESO's right to recover these costs from future ratepayers, constitutes a regulatory asset. The regulatory asset, is transferred to the Fair Hydro Plan Trust.
- The IESO will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
 - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (Electricity Act) and the Ontario Energy Board Act (OEBA).

GA Refinancing – Accounting Considerations

- 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.
- PSAS is 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 in this scenario.
- Section PS 1150.07 from the Public Sector Accounting Handbook:
 - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.*
- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- OFHP 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.

Questions?

From: [Pichette, Marc \(MOF\)](#)
To: [Usman Zahid](#); [Anna Strathy](#)
Subject: FW: Final OFHP AG Products
Date: Tuesday, October 17, 2017 12:25:13 PM
Attachments: [Fact Sheet - Oct. 17 - FINAL.pdf](#)
[FINAL OFHP - Media Briefing.pdf](#)

fyi

From: Barbaro, Rachel (ENERGY)
Sent: October 17, 2017 11:18 AM
To: Lone, Dianne (MOF)
Cc: Evans, Karen (ENERGY)
Subject: Final OFHP AG Products

Hi Dianne, finals attached. Pls note, nothing is going on newsroom or going out to media. MO will use fact sheet reactively.

Thanks
Rachel

Rachel Barbaro

Manager, Strategic Communications
Ministry of Energy, Communications Branch
416 212 4634

Auditor General's Special Report on the Ontario Fair Hydro Plan

October 17, 2017

The special report from the Office of the Auditor General (OAG) focuses on the financial and accounting framework of Ontario's Fair Hydro Plan (OFHP), which is delivering the single largest reduction in electricity rates in the province's history by lowering electricity bills by an average of 25% for residential consumers, and holding increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting.

Refinancing the Global Adjustment (GA)

- To relieve the current burden on ratepayers and share costs more fairly, OFHP is refinancing a portion of the GA, which recovers costs associated with recent investments in the electricity system.
- Refinancing the GA provides significant and immediate rate relief by spreading the cost of electricity system investments over the expected useful life of the generation assets that have been built.
- In developing the policy to refinance the 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.
- The GA refinancing design 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's Fair Hydro Plan Accounting

- 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 the development of GA refinancing, the government and its agencies consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- The Independent Electricity System Operator (IESO) will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and

- The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- PSAS is 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
 - The IESO consulted US GAAP, which has the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the Ontario Energy Board (OEB) in accordance with the Electricity Act and the Ontario Energy Board Act.

Ontario Power Generation as Financial Services Manager

- Ontario Power Generation (OPG) has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
- OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.
- OPG currently manages approximately \$20 billion in nuclear funds and as an entity regulated by the Ontario Energy Board (OEB), OPG has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.
- Further, the structure of the OFHP incents OPG, in its role as FSM, to keep the cost of borrowing to a minimum by basing a portion of its management fees on its ability to achieve lower than forecast interest rates.
- OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.

Financial Accountability Office's Report on the Costs of the Ontario's Fair Hydro Plan

- The Financial Accountability Office's (FAO) report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry 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 FAO released its report in May 2017. The 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 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The FAO report concludes by saying “the FAO’s estimates are subject to many assumptions and uncertainties ... Fiscal impact may differ significantly from the FAO’s estimates.”
- OPG is now 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 FAO.
- The government will also 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.

Ontario's Fair Hydro Plan – Status Update

Technical Briefing

October 17, 2017

Ontario's Electricity System

- Ontario's electricity system is a \$20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries – with costs transparently recovered.
- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It approves rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.
- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it. It also manages contracts with non-regulated generators. In addition, the IESO plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.
- Ontario Power Generation (OPG) is wholly-owned by the Province of Ontario and produces almost half of the electricity used in Ontario. OPG owns and operates: two nuclear stations, 66 hydroelectric stations, two biomass stations and one thermal station.

Ontario's Fair Hydro Plan

- Ontario's Fair Hydro Plan (OFHP) is delivering rate relief to residential consumers, farms, most small businesses, long-term care homes and condominiums. This includes the 8% rebate equivalent to the provincial portion of the HST that came into effect on January 1, 2017.
- OFHP is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.
- The government, OPG, IESO, OEB, key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.
- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
 - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
 - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
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Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.
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- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- OFHP 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.

Questions?

To: [Gadi Mayman](#)
Subject: FW: SCOPA - Confirming MOF Issues
Date: Monday, November 26, 2018 3:19:55 PM
Attachments: [Copy of SCOPA Swim Lanes DRAFT 20180112.xlsx](#)
[AG report Chapter 2.pdf](#)
Importance: High

Hi Gadi,

TBS has prepared the attached summary of topics/issues that could come up at SCOPA and assigned leads from TBS, MOF, Energy, IESO and OPG. The summary will be used to develop briefing materials, etc.

I've reviewed what they've listed under your area of expertise, and all checks out except for the ***Financial Accountability Officer Reports***. Of course, if it's

From: Kim, Minzi (MOF) [mailto:Minzi.Kim@ontario.ca]
Sent: Tuesday, January 16, 2018 12:48 PM
To: Anna Strathy <Anna.Strathy@ofina.on.ca>; Usman Zahid <Usman.Zahid@ofina.on.ca>; Birks, Ryan (MOF) <Ryan.Birks@ontario.ca>; Ghufuran Tarin (MOF) <Ghufuran.Tarin@ontario.ca>; Surani, Alykhan (MOF) <Alykhan.Surani@ontario.ca>; Cheryl Donais (MEDTE/MRI) <Cheryl.Donais@ontario.ca>
Cc: Jonathan Tekle (CAB) <Jonathan.Tekle@ontario.ca>; Kobrinsky, Liza (MOF) <Liza.Kobrinsky@ontario.ca>; David McLean (MOF) <David.McLean@ontario.ca>; Peter Spadoni (MCYS) <Peter.Spadoni@ontario.ca>
Subject: SCOPA - Confirming MOF Issues
Importance: High

Hi everyone,

To prepare for the upcoming SCOPA (Feb 28th), TBS has prepared the attached chart outlining the topics that are applicable to MOF.

Could you please review this chart and let me know if all the proper topics are covered?

FSPD – aside from the topics that are already covered, I've identified "Update on WSIB" on page 70 of the AG's annual report. Could you please review and see if this is something that you guys can provide input on?

We'll need to ensure that all the major issues are captured at this time as this will become the reference point preparing for briefing binder contents.

Please let me know your response **by tomorrow, 2pm.**

Thanks,
Minzi

STANDING COMMITTEE ON PUBLIC ACCOUNTS

CONSIDERATION OF CHAPTER 2, PUBLIC ACCOUNTS OF THE PROVINCE
FEBRUARY 2018

Topic	Cabinet Office	Treasury Board Secretariat			Ministry of Finance		Ministry of Energy					
	Secretary of Cabinet	Deputy Minister	Associate Deputy Minister, OTB	ADM, OPCD	Deputy Minister	CEO, OFA	Deputy Minister	ADM	Pres. & CEO, OPG	SVP & CFO, OPG	Pres. & CEO, IESO	VP & CFO, IESO
	Steve Orsini	Helen Angus	Karen Hughes	Cindy Veinot	Scott Thompson	Gadi Mayman	Serge Imbrogno	Steen Hume	Jeffrey Lyash	Ken Hartwick	Peter Gregg	Kimberley Marshall
Pension Asset Accounting		PENSION ACCOUNTING LEAD										
Rec # 1 - Pension Asset Accounting		Overall - Pension Asset Accounting	Details - Pension Asset Accounting	Details - Pension Asset Accounting								
Advisory Panel Compensation				Advisory Panel Compensation								
IESO Accounting							IESO LEAD					
Rec # 2 IESO Market Accounts											IESO Market Accounts	IESO Market Accounts
Rec #3 IESO Rate-Regulated Accounting											IESO Rate-Regulated Accounting	IESO Rate-Regulated Accounting
AG Audit of 2017 Statements												
OPG/IESO 'Inappropriate' Expenses												
OPG Executive Compensation												
Ontario Fair Hydro Plan							OFHP LEAD					
Rec #4 OFHP Accounting												
Rec #8 'Legislated Accounting'												
Rec #9 Arm's Length Trusts Records												
Re-design of hydro bills												
Pre-Election Report												
Rec #5 Pre-Election Report on Ontario's Finances												
Province's Fiscal Situation												
Rec #6 Province's Debt Burden												
Financial Accountability Officer Reports												
Credit Ratings												
Preparation of Public Accounts												
#7 External Advisors												
Rec #10 Timeline of Finalization of Financial Statements												
Audit Opinion												
Other Topics												

Public Accounts of the Province

1.0 Summary

This year, the audit opinion on the Province's consolidated financial statements is qualified. Based on our audit work, we have concluded that the Province's consolidated financial statements for 2016/17 are fairly presented except for the two items disclosed in the basis-for-qualified-opinion paragraph. The two items are:

- The government overstated the net pension asset relating to the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP).
- The government inappropriately recognized and consolidated the market account assets and liabilities relating to transactions between power generators and distributors managed by the Independent Electricity System Operator (IESO).

The issuance of a qualified audit opinion should not be taken lightly. In reaching this opinion, the Office of the Auditor General supplemented its own extensive work with external advice.

The government did not record a valuation allowance against the net pension asset relating to the OTPP and the OPSEUPP in its consolidated statement of financial position. As a result, the Province's net debt and accumulated deficit at March 31, 2017, is understated by \$12.429 billion (March 31, 2016 – \$10.985 billion) and the 2016/17 annual deficit is understated by \$1.444 billion

(2015/16 – \$1.831 billion). The government inappropriately recorded the market account assets and liabilities of the IESO in its consolidated financial statements, resulting in an overstatement of Other Assets and Other Liabilities at March 31, 2017, by \$1.652 billion (March 31, 2016 – \$1.443 billion) with no effect on the 2016/17 and 2015/16 annual deficits.

We also include an Other Matter paragraph in the auditor's report referencing the fact that the Province's March 31, 2017, consolidated financial statements recognized rate-regulated assets, which is not permitted when applying Canadian Public Sector Accounting Standards (PSAS) to government financial statements. The Other Matter paragraph notes that although the adoption of rate-regulated accounting at the consolidated provincial level did not result in material misstatement in the Province's 2016/17 consolidated financial statements, the statements may become materially misstated in future periods as a result of the legislated accounting prescribed under the *Ontario Fair Hydro Plan Act, 2017*. In our audit opinion, "legislated accounting" refers to the government creating an asset through legislation.

Canadian PSAS are the most appropriate accounting standards for the Province to use in preparing its consolidated financial statements because they ensure that information provided by the government about the surplus and the deficit is fair, consistent and comparable to data from previous years and from peer governments. This allows

all legislators and the public to better assess government management of the public purse. Therefore, the receipt of audit qualifications from the Auditor General for the past two years is a serious matter that should concern legislators and the public.

Annually, we have raised the issue of the government having introduced legislation on a number of occasions to facilitate their establishment of specific accounting practices that may not be consistent with Canadian PSAS. Until now, such actions have not resulted in a material impact on the Province's consolidated financial statements. However, the use of legislated accounting treatments by the government, such as that used to support the accounting/financing design prescribed under the *Ontario Fair Hydro Plan Act, 2017*, could have a material impact on the annual results and become a significant concern to our Office as early as next year. More discussion of this issue can be found in our Special Report titled *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money*, tabled in the Legislative Assembly on October 17, 2017.

Additional Issues

The Government's Use of Consultants

We noted the government engaged external advisers to help design the complex accounting/financing structure of the Fair Hydro Plan rate reduction, and sought advice from accounting firms on parts of the transaction. However, despite the recommendation made in our *2016 Annual Report* that any advice obtained from or work performed by external advisers in formulating an accounting position be shared with our Office, the government did not inform us of their advisers' work until we became aware that significant discussions were being held on matters related to the Fair Hydro Plan, and we specifically requested information.

Moving forward, the interests of the Office of the Treasury Board and the Office of the Auditor General will be best served when the work of external advisers, impacting not only the current year's

consolidated financial statements of the Province, but those of future years as well, is brought to our attention and discussed on a timely basis.

The Auditor General's Reliance on Component Auditors

As the auditor of the Province's consolidated financial statements, we regard as important the work done by private-sector component auditors, who audit the entities that are consolidated into the government's financial statements. Every year, we issue instructions to specific component auditors in order to obtain information about the audit of their component. We use this information to support our audit opinion on the Province's consolidated financial statements. To promote timeliness, we set deadlines for the responses, and emphasize that any significant or unusual events are to be reported to us as early as possible.

During this year's audit, we experienced significant delays in receiving timely communication from the component auditor of the Independent Electricity System Operator (IESO). This is concerning because we disagreed with changes made to the IESO's accounting policies that are significant not only to the Province's 2016/17 consolidated financial statements, but also to future reporting. Our October 17, 2017, Special Report titled *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money* highlight that these changes were integral to the accounting/financing structure being designed under the Fair Hydro Plan to ensure that the Province's consolidated financial statements would not show the financial impact of the rate reduction in its annual results and net debt.

The transparency and timeliness of communication between the Office of the Auditor General and component auditors must be preserved as the interests of all parties are best served when there is full and open disclosure of significant matters affecting the consolidated financial statements.

The Increasing Debt Burden of the Province of Ontario

The Province's growing debt burden also remains a concern this year, as it has been since we first raised the issue in 2011. This year, as in the past, we focus on the critical implications of the growing debt for the Province's finances. We maintain the view that the government should provide legislators and the public with long-term targets for addressing Ontario's current and projected debt, and we reaffirm our recommendation that the government develop a long-term debt-reduction plan.

Reduction of the Unfunded Liability of the Workplace Safety Insurance Board

Our *2009 Annual Report* discussed the risk posed at the time to the financial viability of the Workplace Safety Insurance Board (WSIB) by its unfunded liability, which is the difference between the value of the WSIB's assets and its estimated financial obligations to pay benefits to injured workers. In 2009, we also urged the government to reconsider the exclusion of the WSIB's financial results from the Province's consolidated financial statements, particularly if there were any risks that the Province might have to provide funding to ensure the WSIB remained viable.

In response to our concerns and to the recommendations of the report, the government passed a Regulation under the *Workplace Safety and Insurance Act, 1997* in June 2012 that was effective January 1, 2013, requiring the WSIB to ensure it meets a funding ratio by specified dates. As of December 31, 2016, the WSIB reported a Sufficiency Ratio of 87.4%. This means the WSIB has already achieved its December 31, 2022, funding requirement. As a result of commitments by the government and the WSIB to address the unfunded liability and the progress the WSIB has made so far, we support the exclusion of WSIB's unfunded liability from the Province's liabilities.

Ontario Pre-Election Report Mandate

The *Fiscal Transparency and Accountability Act, 2004* (Act) states, among other things, that in such circumstance as may be prescribed by regulation, the Ministry of Finance shall release a report on Ontario's finances and shall do so before the deadline established by regulation. The purpose of this report is to provide the public with detailed information to enhance its understanding of the Province's estimated future revenues, expenses, and projected surpluses or deficits for the next three fiscal years. According to the *Election Act*, Ontario's next provincial general election will be held on June 7, 2018. Under the *Fiscal Transparency and Accountability Act, 2004* the Auditor General must review the report to determine whether it is reasonable, and release an independent report describing the results of her review. We will work closely with the Ministry of Finance and Treasury Board Secretariat as we prepare for and undertake our review in order to issue our report sufficiently ahead of the June 7, 2018, general election.

This chapter contains 10 recommendations, consisting of 14 actions, to address our observations.

2.0 Background

Ontario's Public Accounts for the fiscal year ending March 31, 2017, were prepared under the direction of the Minister of Finance, as required by the *Financial Administration Act*, and the President of the Treasury Board. The Public Accounts consist of the Province's Annual Report, including the Province's consolidated financial statements, and three supplementary volumes of additional financial information.

The government is responsible for preparing the consolidated financial statements for the Province of Ontario and ensuring that this information, including many amounts based on estimates and judgment, is presented fairly. The government

is also responsible for ensuring that an effective system of internal controls, with supporting procedures, is in place to authorize transactions, safeguard assets and maintain proper records.

Our Office, under the *Auditor General Act*, is responsible for the annual audit of these consolidated financial statements. The objective of our audit is to obtain reasonable assurance that the statements are free of material misstatements—that is, free of significant errors or omissions. The consolidated financial statements, along with the Auditor General's Independent Auditor's Report, are included in the Province's Annual Report.

The Province's 2016/17 Annual Report also contains a Financial Statement Discussion and Analysis section that provides additional information regarding the Province's financial condition and fiscal results for the year ended March 31, 2017. Providing such information is intended to enhance the fiscal accountability of the government to both the Legislative Assembly and the public.

The three supplementary volumes of the Public Accounts consist of the following:

- **Volume 1**—unaudited statements from all ministries and a number of schedules providing details of the Province's revenue and expenses, its debts and other liabilities, its loans and investments, and other financial information;
- **Volume 2**—audited financial statements of significant provincial corporations, boards and commissions whose activities are included in the Province's consolidated financial statements, as well as other miscellaneous audited financial statements; and
- **Volume 3**—detailed unaudited schedules of ministry payments to vendors and transfer-payment recipients.

Our Office reviews the information in the Province's Annual Report, and in Volumes 1 and 2 of the Public Accounts, for consistency with the information presented in the Province's consolidated financial statements.

The *Financial Administration Act* requires that, except in extraordinary circumstances, the government deliver its Annual Report to the Lieutenant Governor in Council within 180 days of the end of the fiscal year. The deadline for this year was September 27, 2017. The three supplementary volumes must be submitted to the Lieutenant Governor in Council within 240 days of the end of the fiscal year. Upon receiving these documents, the Lieutenant Governor in Council must lay them before the Legislative Assembly or, if the Assembly is not in session, make the information public and then lay it before the Assembly within 10 days of the time it resumes sitting.

This year, the government released the Province's 2016/17 Annual Report and Consolidated Financial Statements, along with the three Public Accounts supplementary volumes on September 7, 2017, meeting the legislated deadline.

The Auditor General's audit opinion on the Province's consolidated financial statements was qualified for two accounting treatments that did not conform to Canadian PSAS.

The first qualification relates to the government's accounting for its calculated net pension asset of \$12.429 billion for two pension funds it co-sponsors, the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan. As a result, the annual deficit is understated by \$1.444 billion for 2016/17 (\$1.831 billion in 2015/16) and the net debt and accumulated deficit are understated by \$12.429 billion for 2016/17 (\$10.985 billion in 2015/16).

The second qualification relates to the government inappropriately recording the market account assets and liabilities relating to transactions between power generators and distributors managed by the Independent Electricity System Operator, in its consolidated financial statements. As a result, Other Assets and Other Liabilities are overstated by \$1.652 billion (\$1.443 billion in 2015/16).

A qualified opinion in the public sector should be considered just as serious as a qualified audit opinion received by a publicly traded corporation.

The qualified audit opinion on the Province's consolidated financial statements is discussed in **Section 3.0**.

3.0 The Province's 2016/17 Consolidated Financial Statements

3.1 Auditor's Responsibilities

As the Legislature's independent auditor of the Province's consolidated financial statements, the Auditor General's objective is to express an opinion on whether the financial statements are free of material misstatements and are prepared in accordance with Canadian PSAS so that they give a true and fair view of the financial position and results of the Province. It is this independence, combined with the professional obligation to comply with established Canadian Auditing Standards and relevant ethical requirements, which allows the Auditor General to issue an opinion that provides users with confidence in the Province's consolidated financial statements.

To enable the Auditor General to form her opinion, our Office collects sufficient appropriate audit evidence and evaluates it to determine whether the financial statements are free of material misstatements. This includes assessing the government's preferred accounting treatment over certain transactions and analyzing the appropriateness of those treatments under Canadian PSAS.

An assessment of what is material (significant) and immaterial (insignificant) is based primarily on our professional judgment. In making this assessment, we seek to answer the following question: "Is this error, misstatement or omission significant enough that it could affect decisions made by users of the Province's consolidated financial statements?" If the answer is yes, then we consider the error, misstatement or omission as material.

To help us make this assessment, we determine a materiality threshold. This year, as in past years, and consistent with most other auditors in provincial jurisdictions, we set our threshold at 0.5% of the greater of government expenses or revenue for the year.

Our audit is conducted on the premise that management has acknowledged certain responsibilities that are essential to the conduct of the audit in accordance with Canadian Auditing Standards. These responsibilities are discussed below.

3.2 Management's Responsibilities

The auditor's report distinguishes between the responsibilities of management and of the auditor with respect to a financial statement audit. Management is responsible for the preparation of the financial statements in accordance with Canadian PSAS. The auditor examines the financial statements in order to express an opinion as to whether the financial statements have been prepared in accordance with Canadian PSAS. The division of responsibility between management and the auditor is fundamental and preserves the auditor's independence, a cornerstone of the auditor's report.

In addition to the preparation of the financial statements and having the relevant internal controls, management is also required to provide the auditor with all information relevant to the preparation of the financial statements, additional information that the auditor may request, and unrestricted access to individuals within the entity who the auditor determines are necessary to obtain audit evidence. Canadian Auditing Standards are clear on these requirements, and the fulfilment of these is formally communicated to the auditor in the form of a signed management representation letter at the end of the audit.

When a transaction occurs, it is management's responsibility to identify the applicable accounting standards, determine the implications of the standards on the transaction, decide on an accounting policy and ensure that the financial statements

present the transaction in accordance with the applicable financial reporting framework (e.g., Canadian PSAS for governments). The auditor must also be proficient in the applicable financial reporting framework in order to form an independent opinion on the financial statements, and may perform similar procedures in identifying the applicable standards and understanding the implications of the standards on the accounting transaction. However, unlike management, the auditor does not select an accounting policy or the bookkeeping entries for the organization. These decisions are in the hands of management—in Ontario’s case, Treasury Board Secretariat and the Ministry of Finance, both with support from the Office of the Provincial Controller Division.

When there are disagreements between an auditor and management on the application or adequacy of accounting policies, the auditor must assess the materiality or significance of the issue to the overall financial statements in forming the audit opinion. If the issue is material, it would result in a qualified opinion in which the auditor concludes that the financial statements are fairly presented except for the items described in the basis for the qualification. Again, this distinguishes the role of management and auditor such that the auditor examines the financial statements to express an opinion, whereas management prepares the financial statements.

The Office of the Auditor General may make suggestions about the consolidated financial statements but this does not change management’s responsibility for the financial statements. Similarly, the government may seek external advice on accounting treatments of certain transactions. In such situations, the government still has the ultimate responsibility for the decisions made, and the use of external advisers does not diminish, change or substitute the government’s accountability as the preparer of the Province’s consolidated financial statements.

3.3 The Independent Auditor’s Report

The auditor’s report, which is issued at the conclusion of an audit engagement, is comprised of:

- an introductory paragraph that identifies the financial statements audited;
- a description of the responsibility of management for the proper preparation of the financial statements in accordance with the applicable financial reporting framework;
- a description of the auditor’s responsibility to express an opinion on the financial statements and the scope of the audit; and
- an opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.

The auditor’s report may further include:

- an Emphasis of Matter paragraph that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements; and
- an Other Matter paragraph that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor’s judgment, is relevant to user’s understanding of the audit, the auditor’s responsibilities or the auditor’s report.

3.4 The Significance of a Qualified Audit Opinion

The independent auditor’s report is the way the auditor communicates their opinion to the users of the financial statements as to whether the financial statements of an entity are presented fairly. After the audit of the financial statements is completed, the auditor can sign one of four possible opinions:

- **Unqualified, or clean, opinion:** The financial statements present fairly, in all material

respects, the financial position and results of the entity.

- **Qualified opinion:** The statements contain one or more material misstatements or omissions.
- **Adverse opinion:** The statements do not fairly present the financial position, results of operations and changes in financial position, as per generally accepted accounting principles.
- **No opinion:** It is not possible to give an opinion on the statements because, for example, key records of the entity were destroyed and thus unavailable for examination.

An *unqualified* audit opinion indicates financial statements are reliable. When an auditor issues a *qualified* opinion, he or she is expressing concern about the entity's compliance with the accounting standards issued by the standard setter (e.g., the Public Sector Accounting Board), or about the auditor's ability to obtain sufficient and appropriate information on the financial statements.

An audit qualification is generally a rare occurrence. In fact, the audit opinions on the consolidated financial statements of the Province were not qualified for 22 years. The audit opinion on the Province's March 31, 2017, consolidated financial statements is qualified because the Province's consolidated financial statements do not comply with Canadian PSAS, reflecting the Auditor General's concern about the fair presentation of the Province's consolidated financial statements.

3.5 The 2016/17 Audit Opinion

The *Auditor General Act* requires that we report annually on the results of our examination of the Province's consolidated financial statements. The Independent Auditor's Report to the Legislative Assembly on the Province's Consolidated Financial Statements for the year ended March 31, 2017, is reproduced on the following pages.

3.6 The Reasons for the Qualified Audit Opinion

This year, the audit opinion on the Province's consolidated financial statements is qualified.

Based on our audit work, we have concluded that the Province's consolidated financial statements for 2016/17 are fairly presented except for the two items disclosed in the basis-for-qualified-opinion paragraph. The two items are:

- The government overstated the net pension asset relating to the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP).
- The government inappropriately recognized and consolidated the market account assets and liabilities relating to transactions between power generators and distributors managed by the Independent Electricity System Operator (IESO).

3.6.1 Net Pension Asset Overstated

Net Pension Asset and the Consolidated Financial Statements

As at March 31, 2017, the government reported net pension assets from the OTPP of \$11.511 billion (2015/16 – \$10.147 billion) and from the OPSEUPP of \$0.918 billion (2015/16 – \$0.838 billion), for a total of \$12.429 billion (2015/16 – \$10.985 billion). However, a full valuation allowance against the pension assets should have been recorded in order to comply with Canadian PSAS. Recording a full valuation allowance would require the net pension asset reported on the consolidated statement of financial position to be reduced by \$12.429 billion (2015/16 – \$10.985 billion), resulting in a net pension liability of \$1.396 billion (2015/16 – \$1.673 billion) being reported. This is illustrated in **Figure 1**.

The effect on the consolidated statement of operations of recording the full valuation allowance against the net pension asset for the OTPP and the OPSEUPP would increase the Province's reported annual deficit by \$1.444 billion (2015/16 – \$1.831 billion).



Office of the Auditor General of Ontario
Bureau de la vérificatrice générale de l'Ontario

INDEPENDENT AUDITOR'S REPORT

To the Legislative Assembly of the Province of Ontario

I have audited the accompanying consolidated financial statements of the Province of Ontario, which comprise the consolidated statement of financial position as at March 31, 2017, and the consolidated statements of operations, change in net debt, change in accumulated deficit and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

The Government of Ontario (Government) is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian public sector accounting standards, and for such internal control as the Government determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Government, as well as evaluating the overall presentation of the consolidated financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

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Basis for Qualified Opinion

Net Pension Asset Overstated, Annual Deficit Understated, Net Debt Understated and Accumulated Deficit Understated

As described in Note 16a to these consolidated financial statements, a net pension asset is recorded on the Consolidated Statement of Financial Position relating to the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan. However, the Government does not have the unilateral legal right to use this asset because its ability to reduce future minimum contributions or withdraw any pension plan surplus is subject to agreement with the respective pension plans' joint sponsors. Canadian public sector accounting standards require the Government to record a valuation allowance against this asset.

The Government did not record a valuation allowance for this net pension asset at March 31, 2017. The Government also retroactively restated the March 31, 2016 comparative figures to exclude the valuation allowance previously included in the prior year's consolidated financial statements. This departure from Canadian public sector accounting standards has led me to express a qualified opinion on the consolidated financial statements for the year ended March 31, 2017 and on the March 31, 2016 comparative figures.

The recommendations of the Government's appointed Pension Asset Advisory Panel are not an authoritative source on the application of Canadian public sector accounting standards as implied in Note 16a to these consolidated financial statements.

Effect on Consolidated Statement of Operations

If the Government had correctly recorded the valuation allowance against the net pension asset for the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan, the effect on the consolidated statement of operations for the years ended March 31, 2017 and 2016 would have been as follows:

	2017 (\$ million)	2016 (\$ million)
Annual deficit as presented	(991)	(3,515)
Effect of valuation allowance on:		
• Education expense	(1,364)	(1,480)
• General Government and Other expense	(80)	(351)
Annual deficit in accordance with Canadian public sector accounting standards	(2,435)	(5,346)

Effect on Consolidated Statement of Financial Position

If the Government had correctly recorded the valuation allowance against the net pension asset for the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan, the effect on the consolidated statement of financial position as at March 31, 2017 and 2016 would have been as follows:

	2017 (\$ million)	2016 (\$ million)
Net pension asset as presented	11,033	9,312
Effect of valuation allowance	(12,429)	(10,985)
Net pension liability in accordance with Canadian public sector accounting standards	(1,396)	(1,673)

	2017 (\$ million)	2016 (\$ million)
Net debt as presented	(301,648)	(295,372)
Effect of valuation allowance	(12,429)	(10,985)
Net debt in accordance with Canadian public sector accounting standards	(314,077)	(306,357)

	2017 (\$ million)	2016 (\$ million)
Accumulated deficit as presented	(193,510)	(192,029)
Effect of valuation allowance	(12,429)	(10,985)
Accumulated deficit in accordance with Canadian public sector accounting standards	(205,939)	(203,014)

Inappropriate Consolidation of Independent Electricity System Operator (IESO) Market Accounts

As described in Note 16c to these consolidated financial statements, the IESO changed its accounting policy and applied it retroactively to recognize market account assets and liabilities. The market accounts track mainly buy and sell transactions between market participants (electricity power generators and power distributors). These market accounts, as recorded on the Province of Ontario's consolidated financial statements are not assets and liabilities of the Province of Ontario. The Government has no access or discretion to use the market account assets for their own benefit, nor does the Government have an obligation to settle the market account liabilities in the event of default by market participants. As a result, Other Assets and Other Liabilities are both overstated by \$1.652 billion (2016 – \$1.443 billion). There is no effect on the Consolidated Statement of Operations.

Qualified Opinion

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraphs, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Province of Ontario as at March 31, 2017, and the consolidated results of its operations, change in its net debt, change in its accumulated deficit and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Other Matters

Use of Rate-regulated Accounting May Cause a Material Misstatement on the Consolidated Financial Statements of the Province of Ontario

I draw attention to Note 16c to these consolidated financial statements, which describes the Independent Electricity System Operator's retroactive adoption of rate-regulated accounting during the year. The recognition of rate regulated assets on the consolidated financial statements of the Province of Ontario is not permitted when applying Canadian public sector accounting standards. This departure does not have a material impact on the Province of Ontario's consolidated financial statements for the year ended March 31, 2017 and my opinion is not modified in respect of this matter. However, the consolidated financial statements may become materially misstated in future periods, as a result of the legislated accounting prescribed under the *Ontario Fair Hydro Plan Act, 2017* (Fair Hydro Plan) and its related regulations as it is not in accordance with Canadian public sector accounting standards.

Financial Statement Discussion and Analysis

I draw attention to the Province of Ontario's Financial Statement Discussion and Analysis that discusses the Province of Ontario's financial results without properly reflecting the valuation allowance required in respect of the net pension asset and the recognition of market accounts, as discussed in the Basis for Qualified Opinion paragraphs above.

Toronto, Ontario
August 18, 2017



Bonnie Lysyk, MBA, CPA, CA, LPA
Auditor General

Figure 1: Pension Asset (Liability) as at March 31, 2017

Sources of data: March 31, 2017, Province of Ontario Consolidated Financial Statements and Office of the Auditor General of Ontario

	2017 Pensions (\$ million)	2016 Pensions (\$ million)
Obligation for benefits	124,700	118,448
Less: plan fund assets	(149,851)	(140,834)
Obligation over/(under) plan assets	(25,151)	(22,386)
Unamortized actuarial gains	14,104	13,074
Accrued pension asset	11,047	9,312
Valuation allowance	(14)	—
Net pension asset (liability)¹	11,033	9,312
Additional valuation allowance ²	(12,429)	(10,985)
Net pension asset (liability)³	(1,396)	(1,673)

1. As presented in the March 31, 2017, Province of Ontario consolidated financial statements.

2. Valuation allowance recorded against the accrued pension asset of the Ontario Teachers' Pension Plan \$11.511 billion (2015/16, \$10.147 billion) and Ontario Public Service Employees Union Pension Plan \$0.918 billion (2015/16, \$0.838 billion).

3. In accordance with Canadian Public Sector Accounting Standards.

Discussion of the Accounting Treatment of a Pension Asset under Canadian PSAS

A net pension asset generally arises when the government's total contributions to a plan (plus interest earned thereon) are greater than the pension expense recognized for employee service since the plan's inception.

Canadian PSAS limit the carrying amount of the pension asset. The limit requires a government to record a valuation allowance for any excess of the pension asset over the government's "expected future benefit." In other words, the limit calculation caps the pension asset at an amount equal to the government's expected future benefit. Subsequent changes in a valuation allowance are recorded in the consolidated statement of operations in the period in which the change occurs.

A government's expected future benefit is the benefit a government expects to realize from a pension plan's surplus. The benefit can be in the form of reductions in future required contributions or cash withdrawal of the surplus.

Canadian PSAS provide guidance on the factors to consider in determining whether a benefit should be included in the calculation of a govern-

ment's expected future benefit. The expected future benefit excludes any surplus withdrawals to which the government is not currently entitled, such as those subject to the approval of employees, an appropriate regulatory authority, or, where no such approval has been granted, a court of law.

The standards specifically state that a government may not anticipate obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. The same concepts are applicable when determining the government's ability to reduce its future minimum contributions.

After reviewing the agreements governing the jointly sponsored pension plans in 2015/16, we, along with our expert advisers, determined that the government does not have the unilateral right to reduce contributions without reaching a formal agreement with the plans' other joint sponsors. As a result, we concluded that the government did not have a legally enforceable right to benefit from the pension assets because agreement from the other joint sponsors was not obtained in 2015/16. We arrived at the same conclusion in 2016/17.

For greater certainty, we also examined whether the pension assets met the definition of an asset laid out in the financial statement concepts that underpin all Canadian PSAS. This guidance defines assets as economic resources controlled by a government as a result of past transactions or events, and from which it expects to obtain future economic benefits.

The three essential characteristics of assets are:

- They must embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.
- The government can control the economic resource and access to the future economic benefits.
- The transaction or event giving rise to the government's control has already occurred.

The first characteristic could potentially be met as the pension asset offers the potential for either future cash inflows in the form of approved surplus withdrawals or reduced cash outflows in the form of reductions in future contributions. A further option is that benefits could be increased to members, but in this case, the benefit would flow to the plan members, not the government.

However, the second characteristic is not met, because the government does not control access to the benefits of the plan surplus, including taking any unilateral actions to change its contribution amounts, taking contribution holidays, or withdrawing surplus. Under both plan agreements, these actions require negotiation and agreement between the two joint sponsors. No transaction or event has occurred to give the government this legally enforceable right and, as a result, the government has neither control nor access to the assets. As a result, the third characteristic also is not met.

Therefore, we, along with our expert advisers, concluded that the net pension asset reported by the Province relating to the OTPP and the OPSEUPP was overstated as at March 31, 2017, and March 31, 2016. In other words, because the government cannot access these pension plans' surpluses (as

it has not obtained the agreement from the plans' other joint sponsors to use these surpluses), the recognition of a net pension asset relating to these plans without a valuation allowance contravenes Canadian PSAS.

Applying Canadian PSAS requires an adjustment to recognize a valuation allowance against the total amount of pension assets reported by the OTPP and the OPSEUPP to reflect the expected future benefit. The expected benefit, in this case, is the reduction of future contributions related to the annual costs of the plans. Specifically, according to PSAS section PS 3250.056:

A government determines its expected future benefit as the sum of:

- (a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and
- (b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

This is also consistent with the application of the fundamental concepts in Canadian PSAS for the recognition of assets in general.

The government appointed a pension asset advisory panel that provided the government advice on the interpretation of Canadian PSAS regarding the pension assets. We disagree with the panel's conclusion that the government could record a pension asset for the two pension funds it co-sponsors, the OTPP and the OPSEUPP, without recording a valuation allowance. We further note that this government-appointed panel is not an authoritative source on the application of Canadian PSAS.

In order to remove the audit qualification relating to the net pension asset recorded in the Province's consolidated financial statements, we

would need a signed negotiated agreement from the other joint sponsors of those plans as evidence that the government has a pension asset that it can benefit from today. The government did not record a valuation allowance as required under Canadian PSAS to reduce the net pension asset it reported on its consolidated statement of financial position.

RECOMMENDATION 1

We recommend the government record valuation allowances to offset the net pension assets it has recorded from the Ontario Teachers' Pension Plan and the Ontario Public Sector Employees' Union Pension Plan until such time as it obtains formal written authorization from their pension plan co-sponsors that they are able to lower minimum contributions or withdraw surpluses from the pension funds within the next 12 months.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat does not agree with the recommendation.

3.6.2 Inappropriate Consolidation of the IESO's Market Accounts

We also qualified our 2016/17 audit opinion on the Province's consolidated financial statements as the Province inappropriately recorded market accounts (that are not assets and liabilities of the Independent Electricity System Operator (IESO) or the Province) through the consolidation of the financial results of the IESO without first conforming the IESO's results to be in accordance with Canadian PSAS.

The IESO is classified as an Other Government Organization (OGO) under the provisions of Canadian PSAS, which state that the financial results of an OGO must be conformed to Canadian PSAS prior to consolidation in the government's consolidated financial statements. The market accounts recorded on the IESO's financial statements do not meet the

definitions of an asset or liability within Canadian PSAS from the perspective of the Province's consolidated financial statements.

The IESO, an Ontario provincial government organization, is responsible for operating the electricity market and contracting with independent electricity generators to supplement the electricity provided by Ontario Power Generation Inc. (OPG). Generators and importers supply power into the bulk electricity system to be available to consumers and exporters, including private and municipal distributors such as Power Stream Inc. and the Toronto Hydro-Electric System Ltd. The distributors monitor consumption of electricity by metering their customers' consumption.

Generators generally do not know who is consuming the power they supply to the grid, and distributors generally do not know who they are purchasing their supply from, because they simply access the electricity supply from the grid. The IESO performs the function of a facilitator for settling transactions between electricity market participants such as power generators and electricity distributors, rather than having market participants settle transactions directly with each other. The buyers are the local distribution companies, exporters and large, directly-connected consumers, and the sellers are the power generators and importers.

Market Rules for the Ontario Electricity Market (Market Rules) provide a framework for the operation of the market and the determination of charges payable or receivable from market participants. The IESO's role, as per Ontario Regulation 288/14, is to operate the IESO-administered markets to promote the purposes of the *Ontario Electricity Act, 1998* (Act) and engage in activities related to settlements and payments under contracts entered into under the authority of the Act and payments provided for under the Act or the *Ontario Energy Board Act, 1998*.

To facilitate the flow of cash from the distributors to the generators, the IESO established a number of accounts called Market Accounts, which represent the amounts due from the distributors,

and the amounts owing to the generators. The Market Accounts presented in the IESO financial statements are the point-in-time balances (assets and liabilities) which result from the settlement process between the distributors and the generators. The Market Account assets and liabilities consist of cash restricted for the market activities, a revolving line of credit, interest receivable/payable, due to/from market participants' accounts, and HST receivable.

Based on the Market Rules, the IESO has no role in promoting the interests of one party over another, is not specifically engaged as an agent in economic terms on behalf of any party, and does not have an economic interest in the ultimate consummation of any transaction. The IESO indicates in its public communications that it is the independent administrator of the market. The IESO's Market Rules contain terms that specify its relationship to market participants, and the IESO is not considered a counter-party to the transactions between market participants.

Furthermore, the IESO's Market Rules contain terms that specify the IESO's relationship to market participants and its exposure to financial risks within the Market Accounts.

Specifically, Chapter 9, Section 6.9.2, of the Market Rules states: "The IESO shall not be a counter-party to any trade transacted through the real-time markets." In this term, "trade" is not specifically defined, but is meant to be generic to refer to transactions within the real time market between market participants that are facilitated by the IESO.

Chapter 9, Section 6.16.2, states that subject to the provisions of Section 6.14, "the IESO shall not be liable to make payments in excess of the amount it receives for transactions in the real-time markets."

Section 6.14 addresses remedies of default of a market participant. In summary, the IESO has recovery mechanisms for a default of payment by a market participant, and if those recoveries cannot be made by the specific defaulting market participant, then the funds owed to creditors will be collected from the remaining market participants on a pro-rata basis.

The IESO has no responsibility to settle the market account liabilities in the event of default by market participants, nor does it have any inventory risk related to distributing the electricity to the LDCs or ratepayers.

Canadian PSAS outline the definition and characteristics of an asset in Section PS 3210:

“.03 Assets are economic resources controlled by a public sector entity as a result of past transactions or events and from which future economic benefits are expected to be obtained.

.04 Assets have three essential characteristics:

(a) They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.

(b) The public sector entity can control the economic resource and access to the future economic benefits.

(c) The transaction or event giving rise to the public sector entity's control has already occurred.

.05 Economic resources are not assets unless they meet the three characteristics of assets."

As demonstrated above, there is no economic benefit that accrues to IESO.

Similarly, Section PS 3200 outlines the definition and characteristics of a liability under Canadian PSAS:

.05 Liabilities are present obligations of a government to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits. Liabilities have three essential characteristics:

(a) they embody a duty or responsibility to others, leaving a government little or no discretion to avoid settlement of the obligation;

(b) the duty or responsibility to others entails settlement by future transfer or use of assets, provision of goods or services, or other form of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand; and

(c) the transactions or events obligating the government have already occurred.

.06 Obligations are not liabilities unless they meet the three characteristics of liabilities.

As demonstrated above, the IESO is not liable for any shortfall in cash flows occurring in the period.

Similar to the IESO, the Province has no access/discretion to use the Market Account assets for its own benefit; nor does the Province have an obligation to settle the Market Account liabilities in the event of default by market participants. As such, the Market Accounts do not meet the criteria for recognition as assets and liabilities in the Province's consolidated financial statements.

RECOMMENDATION 2

We recommend that the government remove the Independent Electricity System Operator's Market Accounts from the Province's consolidated financial statements.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat does not agree with the recommendation.

3.7 The Reasons for the Other Matter Paragraph

In addition to the two qualifications to our 2016/17 audit opinion on the Province's consolidated financial statements, we outlined in an Other Matter paragraph that the Province had inappropriately adopted rate-regulated accounting as set out by the U.S. Financial Accounting Standards Board (FASB) in its Accounting Standards Codification 980, Regulatory Operations (ACS 980) under Canadian PSAS.

We arrived at this conclusion because:

- Canadian PSAS is silent on the application of rate-regulated accounting concepts to an OGO or to a government. Canadian PSAS, like other international public-sector standard-setters, must give permission to use rate-regulated accounting. Within PSAS there is no such permission.
- All other accounting standard-setters, including those in the United States, allow for the use of rate-regulated accounting by specifically indicating its use is permitted. That permission usually restricts the adoption of rate-regulated accounting to specific types of government business entities, such as public electric utilities.
- Rate-regulated accounting is not consistent with the primary sources of Canadian generally accepted accounting principles (GAAP) or the concepts set out in Canadian PSAS as required by Section PS 1150, *Generally Accepted Accounting Principles*.
- The IESO and the provincial government are neither government business enterprises nor governmental electric utilities. In Canada, only governmental electric utilities that are considered government business enterprises can use rate-regulated accounting.
- Organizations cannot select individual accounting policies from secondary sources of GAAP without considering the overall environment for which the underlying standards were created.

- The terms and conditions of the contracts entered into by the IESO that are subject to the *Ontario Fair Hydro Plan Act, 2017* were not subject to rate-regulation by the Ontario Energy Board, the Province's regulator. The recovery of IESO's costs of operating the real-time market is not a rate-regulated activity; rather, the Ontario Energy Board determines the fees to be added to the electricity price to allow the IESO to recover its administration costs.

The IESO is classified as an OGO under provisions of Canadian PSAS which state that the financial results of an OGO must be conformed to Canadian PSAS prior to consolidation into the government's financial statements. By consolidating rate-regulated balances recorded in the IESO's financial results without conforming to Canadian PSAS, the government is implying that accounting provisions for rate-regulated accounting found in the FASB ASC 980 can be applied to the Province's consolidated financial statements.

In general, the most widely adopted government accounting standards do not allow governments to create assets and liabilities in their financial statements through the application of rate-regulated accounting. The use of rate-regulated accounting derived from legislation in financial statements prepared using Canadian PSAS would allow governments to manipulate their bottom line to disclose whatever financial result they desire, and would render public reporting of government financial results useless.

The IESO pointed to the GAAP hierarchy outlined in Canadian PSAS Section PS 1150 in adopting the accounting provisions in FASB ASC 980 in its December 31, 2016, financial statements. FASB issues the GAAP that are followed by private-sector entities in the United States.

As the Ontario Government said in a technical briefing on October 17, 2017, regarding the IESO adopting the provisions of U.S. GAAP ASC 980, Section PS 1150.07 of Canadian PSAS states:

.07 No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.

However, Section PS 1150 also notes that a public-sector reporting entity should adopt accounting policies and disclosures that are consistent with the primary sources of GAAP and the PSAS Conceptual Framework. Canadian PSAS Section PS 1150 goes on to describe and name other sources of GAAP, and outlines the concept that the government reporting entity should look to the most relevant secondary sources of GAAP when applying the GAAP Hierarchy.

3.7.1 Canadian PSAS Do Not Permit Rate-Regulated Accounting

Canadian PSAS do not explicitly state that rate-regulated accounting is not allowed; however, the concepts of rate-regulated accounting are not in line with other primary sources of GAAP or the PSAS Conceptual Framework. The silence of Canadian PSAS on rate-regulated accounting means that rate-regulated accounting is not permitted. All other standard-setters for government that allow the use of rate-regulated accounting explicitly permit the use of rate-regulated accounting for certain types of entities.

However, Canadian PSAS allows government business enterprises, such as Ontario Power Generation (OPG) who are more like private-sector businesses in that they sell goods and services and are self-sustaining from the revenue they receive

from those sales, to use rate-regulated accounting. In this case, PSAB specifically exempts OPG from applying Canadian PSAS, and requires it to apply International Financial Reporting Standards (IFRS). This is a specified exemption from applying Canadian PSAS.

Further, some not-for-profit organizations such as universities, colleges and hospitals are specifically permitted by Canadian PSAS—but not required—to apply other standards that may or may not be consistent with the accounting concepts and principles under Canadian PSAS. This is another example of a specified exemption under Canadian PSAS. Given this exemption, a not-for-profit organization's financial statements can still be said to be prepared in accordance with Canadian PSAS.

For governments and government organizations applying Canadian PSAS, there is no specific permission or exemption to use rate-regulated accounting. The only time such permission is given by Canadian PSAS is when a government organization, by exemption, has chosen to prepare its financial statements in accordance with IFRS, and the specific criteria for applying rate-regulated accounting are met under those standards.

It is our view that rate-regulated accounting is not permitted when a government or a government-controlled organization presents its financial statements in accordance with Canadian PSAS.

This view is and has been supported by many public-sector accounting experts in Canada, including Auditors General across Canada, private accounting firms, and others, such as the recently retired Director of the Public Sector Accounting Standards Board, who have extensive experience in developing and applying Canadian PSAS.

The international public-sector standard-setters share the same view that a government's inherent ability to raise revenue in the future is not an asset today. The International Public Sector Accounting Standards Board (IPSASB) Conceptual Framework, BC5.18, states: "A government's power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the

flow of economic benefits to the government." In particular, the IPSASB concluded that "a government's inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits."

In the context of accounting for public-sector entities, this view is even supported in the United States the jurisdiction cited by the IESO.

The Federal Accounting Standards Advisory Board (FASAB), which issues accounting standards for the federal government, states in its Statement of Federal Financial Accounting Concepts 5 (SFFAC 5) *Elements*, paragraph 34:

The government's intent or ability to acquire a resource in the future does not create an asset. For the resource to qualify as an asset, the government already must have acquired the resource or otherwise obtained access to the economic benefits or services it embodies to the exclusion of other entities. For example, the mere existence of the government's power to tax is not an asset because, until the government has exercised that power by imposing a tax and has access to benefits by virtue of completion of a taxable event, no event has occurred to generate resources and there are no resulting economic benefits that the government can control and use in providing programs and services.

The Governmental Accounting Standards Board (GASB), which issues standards for U.S. state and local governments, states in its Concept Statement no. 4 – *Elements of Financial Statements*, paragraph 11:

The power to tax is a distinguishing characteristic of government. Because governments are formed to provide services, frequently irrespective of the ability of specific individuals to pay for those services, governments are often established with the power to tax. That power, while

central to the function of many governments, does not constitute an asset of those governments with that power. A government's power to tax may be considered one of the government's most important resources (that is, a means that can be drawn on), but it is not an asset of the government because the power to tax does not have present service capacity. The power to tax produces an asset for accounting and financial reporting purposes only when the power to tax is exercised and an enforceable tax levy or a taxable transaction occurred, as applicable, has resulted in a resource with present service capacity—taxes receivable.

In 2002, the former Canadian Institute of Chartered Accountants (now CPA Canada) published a research report titled *Financial Reporting by Rate-Regulated Enterprises* that had been jointly commissioned by the Canadian Accounting Standards Board (AcSB) and the Public Sector Accounting Board (PSAB). The report study group was comprised of representatives from the private sector and the public sector, including the then Provincial Controller of Ontario and a representative from the Ontario Energy Board.

Chapter 8 of this 2002 report specifically addressed whether rate-regulated accounting could be applied to the public sector. With respect to the public sector, the research report noted that rate-regulated accounting should only be applied to Government Business Enterprises (GBEs). The report stated: "By inference, although it is not specifically stated in the Public Sector Accounting Handbook, except for GBEs, rate-regulation does not apply to the public sector."

The study group concluded that the scope of public-sector activities that may be considered "rate-regulated" for financial-reporting purposes should be limited to government business enterprises that meet the criteria for qualifying as a rate-regulated enterprise. In our view, the conclusions of the report still apply today.

It has been asserted that rate-regulated accounting is a generally accepted practice. Clearly, there are a number of private and public utilities that use this accounting. However, for the purposes of the Canadian public sector, the use of rate-regulated accounting can only be applied when the organization is a government business enterprise such as Ontario Power Generation, or if the organization chooses to adopt IFRS in preparing its financial statements. Rate-regulated accounting under Canadian PSAS is only permitted when the organization is directed to IFRS, or the organization has chosen to adopt IFRS (where permitted), for the purposes of its own financial statements. The Province does not apply IFRS and, for non-government business enterprise organizations that do, any difference arising between IFRS and PSAS must be adjusted when the Province consolidates such organizations.

3.7.2 U.S. Government Generally Accepted Accounting Standards Permit Rate-Regulated Accounting Only for Government Business Enterprises

The Ontario government pointed out in its technical briefing to media on October 17, 2017, that, whereas the provisions of Canadian accounting standards are principles-based, the provisions of U.S. GAAP are rules-based. The provisions of U.S. GAAP are generally prescriptive in nature. When referring to U.S. GAAP for guidance in developing accounting policies under the hierarchy outlined in Canadian PSAS Section PS 1150, the Province cannot choose which U.S. GAAP rules it wishes to follow, while ignoring other pertinent rules.

As noted above, the Financial Accounting Standards Board (FASB) issues private-sector accounting standards in the U.S. When determining whether a government or government entity can adopt the provisions of U.S. GAAP for rate-regulated accounting (FASB's ASC 980), the most relevant sources of GAAP are the public-sector accounting boards of the United States, including

the Federal Accounting Standards Advisory Board (FASAB) and the Governmental Accounting Standards Board (GASB). FASB's accounting standards cannot be read in isolation of the application of the FASAB or GASB accounting standards.

Both FASAB and GASB restrict the use of FASB's rate-regulated accounting standards to government business enterprises (GBEs). Neither FASAB nor GASB permit the U.S. federal government, state or local governments, or other governmental organizations (other than GBEs) to adopt rate-regulated accounting.

When looking to other international government accounting standard setters, the accounting provisions issued by the International Public Sector Accounting Standards Board (IPSASB) are the most relevant. While the IPSASB permits certain organizations to adopt IFRS, which contain provisions for applying rate-regulated accounting, the effects are removed for the purposes of a government issuing its own financial statements.

3.7.3 Rate-Regulated Accounting Provisions Require an Independent Regulator in Most Cases, Including under Ontario's Regulatory Framework

When issuing a new accounting standard, standard-setters often publish a companion document referred to as the "basis of conclusions." This document provides a more detailed background of discussions that went into setting the new standard and, in some cases, further interpretation of the accounting provisions within that new standard.

In the basis of conclusions for ASC 980 (paragraph 64), FASB notes that ASC 980 does not preclude a governmental utility from adopting the provisions of ASC 980. However, the Province of Ontario is not a governmental utility, and neither is the IESO. Although ASC 980 does not preclude U.S. governmental utilities from adopting rate-regulated accounting, the permission for a governmental utility to adopt these provisions in the U.S. comes from FASAB or GASB (that is, the governmental utility must be a GBE).

Even with the permission to adopt the provisions of ASC 980, a governmental utility must still meet the required criteria for adoption set out in those provisions. These criteria include the requirement for regulated activities to be approved by an independent third-party regulator, except when an entity has been given statutory or contractual authority to establish rates that bind customers. Ontario does not have any governmental utilities that have the statutory or contractual authority to establish rates that bind its customers. The Ontario Energy Board regulates the majority of OPG's electricity generation operations and all of Hydro One's transmission and distribution operations.

Under ASC 980, in a rate-setting model where a regulator sets the electricity rates (as is the case in Ontario with the OEB), that regulator must be independent from the regulated entity in order to apply rate-regulated accounting. As outlined in the basis of conclusions for ASC 980, paragraph 62, "the first criterion is the existence of third-party regulation."

At the Province of Ontario consolidated level, the IESO and OEB are related parties through common control by the Province. As such, the third-party independent relationship required in order to adopt the provisions of ASC 980 does not exist. Therefore, although we believe that the IESO should not record rate-regulated balances, any rate-regulated balance that would be included in the IESO's financial results would have to be eliminated prior to consolidation into the Province's financial statements.

3.7.4 The Contracts to be Smoothed under the Ontario Fair Hydro Plan Are Specifically Excluded from Applying Rate-Regulated Accounting Provisions

The Other Matter paragraph in our Auditor's Report noted that although the adoption of rate-regulated accounting at the provincial level did not result in material misstatement in the Province's 2016/17 consolidated financial statements, the amounts may become materially misstated in future periods

as a result of the *Ontario Fair Hydro Plan Act, 2017* (Act). This statement was based on the estimated annual borrowing required to fund the cash shortfall from applying the rate discount outlined in the Fair Hydro Plan, and the fact that the provisions of U.S. GAAP ASC 980 do not apply to the contracts that are being considered in the Global Adjustment account smoothing plan, not only at the provincial consolidated-financial-statement level but also at the IESO financial-statement level.

The Act refers to the Global Adjustment costs that are to be smoothed under the Fair Hydro Plan as a “clean energy benefit.” The renaming of these costs to be smoothed to a “clean energy benefit” does not change their underlying nature. These costs relate to electricity to be purchased according to contracts with third-party generators. The terms and conditions of these contracts were not subject to rate regulation by the OEB; rather, they were negotiated and agreed to by third-party generators and the IESO (or the former Ontario Power Authority). U.S. GAAP ASC 980 specifically states that its provisions do not apply to contracts whose terms and conditions are not subject to rate regulation.

3.7.5 Rate-Regulated Accounting Provisions Can Only Be Applied to an Entity’s Own Rate Regulated Operations

In addition to the other compelling arguments that rate-regulated accounting should not impact the Province’s consolidated financial statements, it should be noted that the provisions of ASC 980 apply to an entity’s own rate-regulated operations. The asset that is being established by the Act—the right to recover amounts from future ratepayers—does not relate to the IESO’s own operations. As outlined previously in **Section 3.6.2**, the Market Rules state that the IESO is not a party to the transactions of the market.

3.7.6 In Absence of Rate-Regulated Accounting, the Asset Created under the Fair Hydro Plan Would Be Classified as an Intangible Asset and Not Be Recognized under Canadian PSAS

OPG, in its analysis regarding the asset (i.e., the shortfall from paying generators more than what is collected from distributors) that OPG Trust will be purchasing from the IESO, correctly pointed out that the OPG Trust cannot classify this asset as a rate-regulated asset because this asset does not relate to the activities of OPG Trust. OPG’s analysis went on to note that this asset will be classified as an intangible asset.

From the IESO perspective, this right to collect future revenues does not meet the definition of an accounts receivable because the specific ratepayers who will owe this amount in the future cannot be determined until those ratepayers consume electricity in future years at the higher rates reflecting the recovery of the Fair Hydro Plan reduction.

The IESO cannot record the asset as a rate-regulated balance for the many reasons outlined above; nor can the IESO record this balance as an accounts receivable. As such, the right to future recovery of the shortfall of cash received from ratepayers versus the amount due to generators would be classified as an intangible asset under Canadian PSAS, similar to the classification of the asset by the OPG Trust following IFRS.

However, where OPG Trust may be able record an intangible asset under IFRS, the Province cannot record an intangible asset under Canadian PSAS PS 1000.58, which states: “In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements.”

3.7.7 Historical Accounting Precedent – The Electricity Consumer Price Protection Fund

There is precedent in previous government accounting for the electricity rate freeze for the period from May 2002 to March 2004 is similar to our recommended accounting for the proposed transactions under the Fair Hydro Plan.

In May 2002, electricity consumers were introduced to market-based prices. During the summer of 2002, the market price of electricity in Ontario rose to unanticipated levels due to such unforeseen circumstances as warmer-than-seasonal weather. As a result, electricity bills were significantly higher than in 2001. In response, the government enacted the *Electricity Pricing, Conservation and Supply Act, 2002* (Act), which established a single, fixed price for electricity.

The Act, which received Royal Assent on December 9, 2002, aimed to protect electricity consumers by lowering and freezing the price of electricity at 4.3 cents per kilowatt hour (kWh) for families, small businesses and farmers. With passage of the Act, the government fixed the electricity price at 4.3 cents per kWh until 2006, retroactive to May 1, 2002.

Under this program, power generators would receive the market price as set in the electricity market administered by the Independent Market Operator (IMO, now the IESO). The program would be administered through the Electricity Consumer Price Protection Fund (ECPPF), managed by the Ontario Electricity Financial Corporation (OEFC).

As manager, OEFC was required to pay to or receive from the IMO any difference between the current market price (spot price) and the fixed 4.3 cents/kWh charged to consumers under the Act.

When spot prices were higher than 4.3 cents/kWh, OEFC would make a payment to the IMO equal to the difference between the spot price and 4.3 cents/kWh, based on the quantity of electricity consumed. When spot prices were lower than 4.3 cents/kWh, OEFC would receive a payment from the IMO equal to the difference between the spot price and 4.3 cents/kWh, based on the quan-

tity consumed. The ECPPF was to receive a large portion of its funding from the piece of the Market Power Mitigation Agreement rebate paid by Ontario Power Generation (OPG) that was attributable to the low volume and designated consumers.

For the 2002/03 fiscal year, the program resulted in \$665 million in additional costs recorded as an expense in OEFC, reflecting the fact the average price of electricity was greater than the fixed rate of 4.3 cents/kWh. Specifically, expenditures from the ECPPF that amounted to \$1.461 billion in 2002/03 were reduced by a portion of the rebate paid by OPG under the Market Power Mitigation Agreement totaling \$796 million, leaving a net cost in OEFC of \$665 million. In 2003/04, expenditures from the ECPPF during the year amounted to \$643 million, reduced by a portion of the rebate provided by OPG under the Market Power Mitigation Agreement totaling \$390 million, leaving a net cost in OEFC of \$253 million.

On December 18, 2003, the passage of the *Ontario Energy Board Amendment Act, 2003* (Pricing Act), removed the 4.3 cents/kWh price freeze effective April 1, 2004, in favour of another pricing structure. This interim pricing structure was introduced on April 1, 2004, with an expectation that the net cost for the ECPPF would be eliminated in 2004/05. Upon passage of the Pricing Act and its related regulations, the responsibility for managing the ECPPF, that had reported a surplus of \$704 million for the period from April 1, 2004, to March 31, 2005, was transferred to the Ontario Power Authority (OPA) on January 1, 2005. Accordingly, \$176 million of the fiscal 2005 surplus was transferred to the OPA, representing the payments required to be made for the first quarter of 2005. The remaining surplus of \$528 million was reflected as a liability on the balance sheet and would be returned to electricity consumers in a subsequent period.

During the ECPPF's life, 2002/03 and 2003/04 funding program shortfalls that were recovered from electricity ratepayers were recorded as an expense in OEFC's financial statements, and in the

Province's consolidated financial statements, both of which were prepared using Canadian PSAS. The 2004/05 funding program surpluses that were to be returned to electricity ratepayers were recorded as a liability. The accounting policies used for the ECPFF in OEFC's financial statements and in the Province's consolidated financial statements in prior years are consistent with our Office's accounting recommendations for recording the Fair Hydro Plan rate reduction.

RECOMMENDATION 3

We recommend the government follow the accounting standards established by the Public Sector Accounting Board and the Province's historical accounting precedent, and implement the recommendations in the Special Report issued by our Office and tabled in the legislature on October 17, 2017, titled *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money*, as follows:

- record the true financial impact of the Fair Hydro Plan's electricity rate reduction on the Province's budgets and consolidated financial statements; and
- use a financing structure to fund the rate reduction that is least costly for Ontarians.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat does not agree with the recommendation.

4.0 The Government's Use of External Consultants

In our *2016 Annual Report*, we reported on the government's use of external advisers. The government engages external advisers in various capacities that include providing accounting analysis, advice and interpretation. We highlighted that the interests

of the Treasury Board Secretariat, the Ministry of Finance and the Office of the Auditor General are best served when there is full disclosure on the use of external advisers. For this reason, any work performed by external advisers in formulating an accounting position should be shared with the Office of the Auditor General as soon as possible, as part of the audit of the Province's consolidated financial statements. We recommended that the government provide our Office with copies of all contracts with external advisers so that we are aware of the scope of their work performed and can assess its impact on the annual audit. We also recommended that Treasury Board Secretariat incorporate in its contracts with external advisers a provision to notify our Office of their engagement with the Province.

We noted that in 2016/17, as the government designed the accounting/financing structure for the Fair Hydro Plan rate reduction, they engaged external advisers to achieve the desired accounting treatment, and sought advice from private accounting firms on various elements of the transaction at an individual entity level. Despite the recommendation made in our *2016 Annual Report*, the government did not inform our Office of its external engagements until we became aware that significant discussions were being held on matters related to the Fair Hydro Plan that would have an impact on our audit. We requested a formal briefing in early March 2017, but it was not until April 2017 that we received a high-level briefing on the Fair Hydro Plan. The accounting/financing structure was not presented at that briefing. Further, the contracts that the government had with the external advisers on the accounting/financing transaction of the Fair Hydro Plan were not provided to us until we made a specific, formal request for them.

The Office of the Auditor General is mandated under law to be the auditor of the consolidated financial statements of the Province of Ontario. However, our position on the proper accounting for the Fair Hydro Plan rate reduction was not sought despite the fact that on numerous occasions,

ministry staff advised the government that we may not agree with the accounting determined by the ministry staff and therefore the government was acutely aware of the risk that we would take issue with the accounting/financing structure being designed to avoid recording the impact of the rate reduction on the annual deficits and net debt of the Province's consolidated financial statements.

It is important that timely information is provided to our Office and that the accounting for proposed major transactions is transparently discussed with our Office early in the planning stage. The government did not implement our recommendations from last year's Annual Report related to the use of external advisers, and we repeat these recommendations this year.

RECOMMENDATION 4

The Office of the Auditor General is appointed under the *Auditor General Act* as the auditor for the consolidated financial statements of the Province of Ontario. We recommend that the Treasury Board Secretariat:

- proactively supply copies to the Auditor General of all contracts it enters into for accounting advice and opinions in order to ensure that our Office is aware of the work the advisers are performing, can assess significant issues in a timely manner, and can determine their impact on the Province's consolidated financial statements and our annual audit; and
- build into its contracts with external advisers the requirement that the advisers engaged to provide accounting advice and opinions that affect the consolidated financial statements notify our the Office of their engagement as required under the Code of Professional Conduct of the Chartered Professional Accountants of Ontario.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat's use of external expertise for accounting and financial reporting matters supplements its own resources on complex or emerging accounting and reporting matters. External advisers are generally engaged to provide advice and guidance to supplement internal analysis.

Treasury Board is committed to working with the Office of the Auditor General to discuss issues, once the professional staff has completed its analysis of the issue.

5.0 The Roles of the Group Auditor and the Component Auditor

5.1 Introduction

Paragraph 12(2)(f) of the *Auditor General Act* provides for our Office to bring to the attention of the Legislative Assembly any matter relating to the audit of Crown-controlled corporations.

5.1.1 Responsibilities

As noted earlier, the Auditor General is responsible under law to provide an audit opinion on the Province's consolidated financial statements. The consolidated financial statements are comprised of ministries and provincial organizations controlled by the government and include the following:

- four government business enterprises (GBEs): Hydro One, Liquor Control Board of Ontario, Ontario Lottery and Gaming Corporation, and Ontario Power Generation;
- more than 40 other government organizations (OGOs), including the Independent Electricity System Operator, Legal Aid Ontario, Metrolinx, and Ontario Electricity Financial Corporation;

- 14 Local Health Integration Networks (LHINs); and
- more than 250 broader-public-sector organizations (BPS) such as hospitals, colleges and school boards.

Under the Canadian Assurance Standards (CAS), the audit of the consolidated financial statements of the Province of Ontario is determined to be a “group audit.” CAS 600 *Special Considerations – Audits of Group Financial Statements* (CAS 600) includes the requirements for audits under this classification.

A group audit is the audit of financial statements comprised of the financial statement information of more than one component, which is an entity or business activity for which financial information is prepared, and should be included in the consolidated financial statements.

In the Province of Ontario, each of the more than 300 entities grouped above are components. For the requirements of CAS 600 to be met, it is important to have transparent and timely information provided to our Office by the private-sector auditors of the components. As auditor of the group financial statements, we have the ultimate responsibility to ensure that sufficient and appropriate audit evidence is obtained to support the audit opinion on the Province’s consolidated financial statements.

5.1.2 Chronology

Every year, we issue instructions to specific component auditors that include the work to be performed at the component level, the intended use of that work and professionally required communication on matters relevant to our conclusions on the audit of the consolidated financial statements. To promote timeliness, we set deadlines for responses, and emphasize that any significant or unusual events are to be reported to us as early as possible.

Our instructions require a response from the component auditor as it completes key phases of the audit process as outlined in our letter, specifically the pre-engagement, planning and post-engagement phases.

This year, in the case of the IESO component audit, our letter to the IESO private-sector component auditor was dated January 11, 2017. We requested a reply by February 17, 2017, on the first two phases and by June 16, 2017, for the last phase.

We followed up with a phone call to the IESO component auditor in mid-February for a response, but did not receive one. Subsequently we learned that there was an Audit Committee meeting on February 28, 2017, to review a draft of the December 31, 2016, financial statements. During the meeting, management, the IESO component auditor, and an adviser from the same firm discussed with the Audit Committee new accounting policies related to the recording of the market account assets and liabilities on the IESO’s financial statements and the adoption of rate-regulated accounting for the preparation of its financial statements.

As part of the work done by our Office on the Special Report titled *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money*, we now know that management and the IESO auditor were aware that there was a risk that our Office would not accept the proposed rate-regulated accounting policy change on the Province’s consolidated financial statements. The Audit Committee initially asked management to discuss these accounting policies with the Auditor General, but we were never contacted.

Although CAS 600 does not include specific requirements for the component auditors to comply with our letter of instructions, professional responsibilities would dictate that the IESO auditor contact us without delay to inform us when significant or unusual items had occurred. As well, Subsection 9(3) of the *Auditor General Act* requires the person or persons performing the audit of a Crown-controlled corporation to comply with our letter of instructions.

On March 14, 2017, we sent a follow-up email to the IESO component auditor as their response was overdue, and we did not receive a reply. We now know that on March 15, 2017, there was a special meeting of the IESO Audit Committee to discuss

changes in their accounting policies. Following the discussion, the IESO Audit Committee resolved that the accounting policies of the IESO be amended to record market accounts assets and liabilities on the IESO's balance sheet and to adopt rate-regulated accounting. These were significant accounting policy changes.

We received a response from the IESO component auditor on March 21, 2017, on the first two phases requested in our letter of instructions, but there was no mention of any accounting policy changes. The timing of these responses did not give us the opportunity to properly engage in the discussions at the component level, given that the IESO's revised and final financial statements (including restated comparatives) to December 31, 2016, were approved by the Audit Committee and the component auditor provided its audit opinion dated March 22, 2017.

We obtained a copy of the IESO's financial statements from its website shortly after this date. We expressed our disagreement with these changes to the senior management and board members of the IESO. We formally recommended that they correct their financial statements for the policy changes they made, remove the market accounts from their financial statements, and remove rate-regulated accounting. As an "Other Government Organization," the IESO follows Canadian PSAS in preparing its financial statements and is not permitted to use rate-regulated accounting. We expressed these same concerns to the component auditor and the adviser from the same firm that significantly contributed to designing the complex accounting/financing structure for the rate reduction under the Fair Hydro Plan.

Ultimately, the government's decision to rely on the changes to the IESO's accounting policies in preparing the Province's March 31, 2017, consolidated financial statements resulted in a basis-for-qualification paragraph and an Other Matter paragraph in the Auditor General's audit opinion on the Province's 2016/17 consolidated financial statements.

5.1.3 Our Concern

The delay in receiving timely communication is concerning. The changes to the accounting policies made by the IESO resulted in a significant change in their December 31, 2016, financial statements that resulted in a restatement of five years of their prior financial results. However, we were never informed by the IESO component auditor despite earlier requests sent to them requesting that they inform us of items of this nature as soon as possible.

We disagreed with the changes made to the Province's 2016/17 consolidated financial statements resulting from the accounting policy changes made by the IESO. On consolidation, accounting policies of other government organizations have to be conformed on a uniform basis of accounting applicable at the Province's consolidated financial statement level. At the consolidated level, the recognition of the market account assets and liabilities, as well as the use of rate-regulated accounting in the public sector (other than a GBE), is not appropriate, but the government chose not to make these adjustments.

The changes to the IESO's accounting policies are significant, not only to the Province's 2016/17 consolidated financial statements but also to future reporting. As described in our October 17, 2017, Special Report titled *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money*, these changes were integral to the accounting/financing structure being designed under the Fair Hydro Plan to ensure that the Province's consolidated financial statements do not show the financial impact of the rate reduction on the Province's annual results and net debt.

5.1.4 Moving Forward

Following the completion of the audit of the Province's 2016/17 consolidated financial statements, I along with senior staff from my Office held an information session with senior audit partners from the major accounting firms. The purpose of the meeting was to introduce our Office and explain our role under the *Auditor General Act*.

At the same time, I also emphasized that as the auditor of the Province's consolidated financial statements, which include the results of hundreds of entities, I regard the work done by the component auditors as important. The transparency and timeliness of communication between my Office and component auditors must be preserved as the interests of all parties are best served when there is full disclosure and open dialogue on significant matters affecting the financial statements of government agencies, Crown-controlled corporations and, ultimately, the consolidated financial statements for the Province of Ontario.

RECOMMENDATION 5

We recommend that the Independent Electricity System Operator (IESO), an "other government organization," use the Canadian Public Sector Accounting Standards (PSAS) in the preparation of its financial statements. Specifically, it should:

- remove market accounts recorded on its financial statements; and
- discontinue the inappropriate use of rate-regulated accounting in the preparation of its financial statements.

To ensure that the members of the Legislative Assembly receive financial information on the operations of the IESO prepared in accordance with Canadian PSAS, the Office of the Auditor General will conduct an attest audit of the December 31, 2017, financial statements of the IESO as permitted under the *Electricity Act*, Subsection 25.2(2), which states: "The Auditor General may audit the accounts and transactions of the IESO. 2014, c. 7, Sched. 7, s. 3 (1)."

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat does not agree with the recommendation.

6.0 Legislated Accounting Standards

Canadian PSAS have been widely adopted by Canadian federal, provincial, territorial and local governments as the basis for the preparation of their financial statements.

Over time, standards develop to address increasingly complex transactions and emerging financial issues. When changes to standards have a significant impact on the accounting for and measurement of transactions affecting annual deficit/surplus or net debt, governments may be reluctant to adopt them to the extent they generate potential volatility in annual reported results.

As discussed in our *2016 Annual Report*, the government passed legislation in 2008, 2009, 2011 and 2012 giving it the ability to make regulations for specific accounting treatments rather than the wholesale application of independently established accounting standards. In recent years, Ontario has passed legislation or amended regulations to enable it to prescribe accounting policies for its public-sector entities as follows:

- The *Investing in Ontario Act, 2008* (Act) and related regulations allow the government to provide additional transfers to eligible recipients from unplanned surpluses reported in its consolidated financial statements. Any transfers made under the Act would be recorded as an expense of the government for that fiscal year, regardless of the treatment prescribed under Canadian PSAS. Transfers under this Act have occurred only once, in 2007/08. We concluded the accounting for these transfers as an expense was appropriate under Canadian PSAS.
- In 2009, the *Education Act* and the *Financial Administration Act* were amended. The *Education Act* amendments specify that the government could prescribe accounting standards for Ontario school boards to use in

preparing financial statements. The *Financial Administration Act* amendments allow the government to prescribe accounting standards for any public or non-public entity whose financial statements are included in the Province's consolidated financial statements. For example, the Ministry of Education prescribed one accounting treatment to school boards on the adoption of the new PSAS standard PS 3410, Government Transfers, which was not consistent with Canadian PSAS. We ensured that the prescribed accounting treatment was corrected when the financial statements of the school boards were consolidated into the Province's financial statements.

- In 2011, a regulation under the *Financial Administration Act* directed Hydro One, at the time wholly owned by the Ontario government, to prepare its financial statements in accordance with U.S. generally accepted accounting principles (GAAP), effective January 1, 2012. Subsequently, changes were made to the *Financial Administration Act* such that this regulation no longer applied to Hydro One following its initial public offering on the Toronto Stock Exchange in 2015. The government also required another wholly owned government business enterprise, Ontario Power Generation (OPG), to prepare its financial statements in accordance with U.S. GAAP. When the government chose to use U.S. GAAP to record the results of Hydro One and OPG in the Province's consolidated financial statements rather than International Financial Reporting Standards (IFRS), we examined the differences between IFRS and U.S. GAAP, and concluded these differences had no material effect on the Province's annual deficit. The government adopted IFRS for the purposes of recording the results of OPG and Hydro One in the Province's March 31, 2017, consolidated financial statements as required by Canadian PSAS.

- Ontario government regulations require transfers for capital acquisitions and transfers of tangible capital assets to be accounted by recipients as "deferred contributions." The deferred amounts are to be brought into revenue by transfer recipients at the same rate as they recognize amortization expense on the related assets. This prescribed accounting treatment is in accordance with PSAS.
- The 2012 Budget further amended the *Financial Administration Act* to provide the government with full authority to make regulations regarding the accounting policies and practices used to prepare its consolidated financial statements. This legislated provision was used in connection with the preparation of the 2015/16 consolidated financial statements. A time-limited regulation was passed requiring a full valuation allowance to be recorded for jointly sponsored pension plans, which was in accordance with Canadian PSAS, while in effect.
- Most recently, as noted in our Special Report titled *The Fair Hydro Plan: Concerns about Fiscal Transparency, Accountability and Value for Money*, we expressed concerns about the government legislating a complex accounting/financing structure to improperly avoid showing annual deficit and increases in net debt. The "legislated accounting" refers to the government creating a regulatory asset through legislation. This asset represents the difference between what electricity generators are owed and the lesser amount being collected from electricity ratepayers as a result of the electricity rate reduction. Without the legislated accounting, the difference would be recorded as an expense rather than as an asset in the Province's consolidated financial statements.

We have raised the issue of the risk of the government's potential use of legislated accounting treatment on a number of occasions in our previous annual reports. This year, it was used to support inappropriate accounting in the Province's

consolidated financial statements. It is critical that Ontario continue to prepare its financial statements in accordance with generally accepted accounting standards, specifically those of Canadian PSAS, in order to maintain its financial reporting credibility, accountability and transparency.

If the government reports a deficit or surplus under legislated accounting standards that is materially different than what it would be using Canadian PSAS, the Auditor General is compelled to include a qualification in her audit opinion.

RECOMMENDATION 6

We recommend the government follow the accounting standards established by the Public Sector Accounting Board, rather than using legislation and regulations to prescribe accounting treatments.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat does not agree that it does not follow the accounting standards established by the Public Sector Accounting Board.

7.0 Ontario's Debt Burden

In previous annual reports, we have commented on Ontario's growing debt burden, attributable to its large deficits in recent years and its investments in capital assets such as infrastructure. We do so again this year.

In reporting on Ontario's debt burden, we have updated the government's publicly reported debt figures to be in accordance with Canadian PSAS for two issues: properly accounting for the net pension assets of the OTPP and the OPSEUPP, and accounting for the projected costs of the Fair Hydro Plan. Without these adjustments, the improper accounting treatment of these two items understates net debt and the accumulated deficit.

We noted that the Province has relied on historically low interest rates to keep its debt-servicing costs relatively stable, but the debt itself, whether measured as total debt, net debt or accumulated deficit, continues to grow. **Figure 2** shows that the Province's debt levels continue to rise. The three measures of debt are defined below:

- *Total debt* is the total amount of borrowed money the government owes to external parties. It consists of bonds issued in public capital markets, non-public debt, T-bills and U.S. commercial paper. Total debt provides the broadest measure of a government's debt load.
- *Net debt* is the difference between the government's total liabilities and its financial assets. Liabilities consist of all amounts the government owes to external parties, including total debt, accounts payable, pension and retirement obligations, and transfer-payment obligations. Financial assets are those that theoretically can be used to pay off liabilities or finance future operations, and include cash, accounts receivable, temporary investments and investments in government business enterprises. Net debt provides a measure of the amount of future revenues required to pay for past government transactions and events.
- *Accumulated deficit* represents the sum of all past annual deficits and surpluses of the government. It can also be derived by deducting the value of the government's non-financial assets, such as its tangible capital assets, from its net debt.

7.1 Main Contributors to Net Debt

The Province's growing net debt is attributable to its large deficits in previous years, along with its investments in capital assets such as buildings and other infrastructure and equipment acquired directly or through public-private partnerships for the government or its consolidated organizations, such as public hospitals, as illustrated in **Figure 3**.

Figure 2: Total Debt, Net Debt and Accumulated Deficit, 2011/12–2019/20

Sources of data: March 31, 2017, Province of Ontario Consolidated Financial Statements, 2017 Ontario Budget and Office of the Auditor General of Ontario

	Actual (\$ million)						Estimate (\$ million)		
	2011/12 ¹	2012/13 ¹	2013/14 ¹	2014/15 ¹	2015/16 ²	2016/17 ²	2017/18 ¹	2018/19 ¹	2019/20 ¹
Total debt as reported by government	257,278	281,065	295,758	314,960	327,413	333,102	341,058	351,300	362,400
Increase for:									
Fair Hydro Plan ³	—	—	—	—	—	—	2,500	5,000	7,500
Revised total debt per Office of the Auditor General	257,278	281,065	295,758	314,960	327,413	333,102	343,558	356,300	369,900
Net debt as reported by government	235,582	252,088	267,190	284,576	295,372	301,648	311,921	323,300	335,900
Increase for:									
Net pension asset adjustment ⁴	—	—	—	9,154	10,985	12,429	14,472	16,841	19,590
Fair Hydro Plan ³	—	—	—	—	—	—	2,500	5,000	7,500
Revised net debt per Office of the Auditor General	235,582	252,088	267,190	293,730	306,357	314,077	328,893	345,141	362,990
Accumulated deficit as reported by government	158,410	167,132	176,634	187,511	192,029	193,510	193,544	193,500	193,500
Increase for:									
Net pension asset adjustment ⁴	—	—	—	9,154	10,985	12,429	14,472	16,841	19,590
Fair Hydro Plan ³	—	—	—	—	—	—	2,500	5,000	7,500
Revised accumulated deficit per Office of the Auditor General	158,410	167,132	176,634	196,665	203,014	205,939	210,516	215,341	220,590

1. 2017 Ontario Budget.

2. March 31, 2017, Province of Ontario Consolidated Financial Statements.

3. Office of the Auditor General Special Report: *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value for Money*.

4. Assumed growth rate based on past growth rates.

Figure 3: Net Debt Growth Factors, 2010/11–2019/20 (\$ million)

Sources of data: March 31, 2017, Province of Ontario Consolidated Financial Statements, 2017 Ontario Budget and Office of the Auditor General of Ontario

	Net Debt Beginning of Year	Deficit/ (Surplus)	Net Investment in Tangible Capital Assets ¹	Miscellaneous Adjustments ²	Net Debt End of Year	Increase/ (Decrease)
Actual						
2010/11	193,589	14,011	7,306	(395)	214,511	20,922
2011/12	214,511	12,969	7,234	868	235,582	21,071
2012/13	235,582	9,220	7,784	(498)	252,088	16,506
2013/14	252,088	10,453	5,600	(951)	267,190	15,102
2014/15	267,190	10,315	6,509	9,716	293,730	26,540
2015/16	293,730	5,346	5,450	1,831	306,357	12,627
2016/17	306,357	2,435	4,795	490	314,077	7,720
Estimated						
2017/18	314,077	4,543	13,100	(2,827)	328,893	14,816
2018/19	328,893	4,869	15,400	(4,021)	345,141	16,249
2019/20	345,141	5,249	17,100	(4,500)	362,990	17,849
Total over 10 years	—	79,409	90,278	(287)	—	169,401

1. Includes investments in government-owned and broader-public-sector land, buildings, machinery and equipment, and infrastructure assets capitalized during the year less annual amortization and net gains reported on sale of government-owned and broader-public-sector tangible capital assets.

2. Unrealized Fair Value Losses/(Gains) on the Ontario Nuclear Funds Agreement (ONFA) Funds held by Ontario Power Generation Inc. and accounting changes. In 2014/15, a valuation allowance of \$9.154 billion was correctly made to the net pension asset.

After properly accounting for the net pension assets of the OTPP and the OPSEUPP and the expected costs of the Fair Hydro Plan, the Province will continue to have annual deficits over the next three years, and net debt will continue to increase as the government borrows to finance its operations.

In fact, Ontario's net debt will have increased by 88% over a 10-year period, from \$193.6 billion in 2010/11 to approximately \$363.0 billion by 2019/20. We estimate total debt will almost total \$370 billion by 2019/20.

To put this in perspective, the amount of net debt owed by each resident of Ontario on behalf of the government will increase from about \$15,000 per person in 2010 to about \$23,000 per person in 2020. In other words, it would cost every Ontarian \$23,000 to eliminate the Province's net debt.

7.2 Ontario's Ratio of Net Debt to GDP

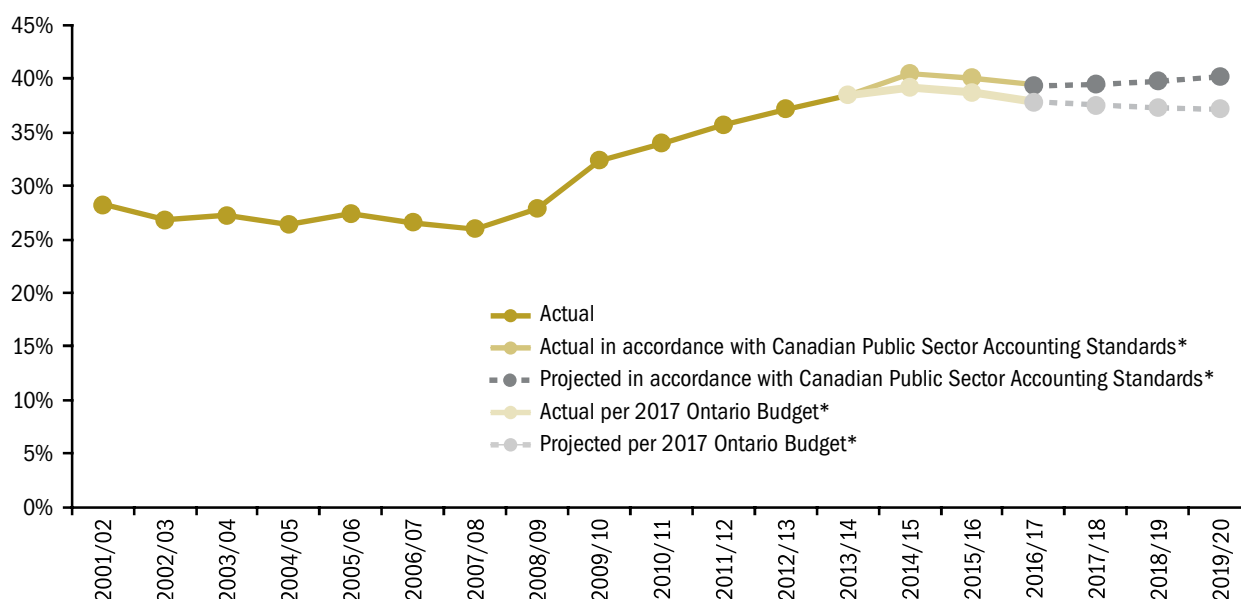
A key indicator of the government's ability to carry its debt is the level of debt relative to the size of the economy. The ratio of net debt to the market value of goods and services produced by an economy (the gross domestic product, or GDP) measures the relationship between a government's obligations and its capacity to raise the funds needed to meet them. It is an indicator of the burden of government debt on the economy.

If the amount of debt that must be repaid relative to the value of the GDP is rising—in other words, the ratio is rising—it means the government's net debt is growing faster than the provincial economy, and becoming an increasing burden.

Figure 4 shows that the Province's net-debt-to-GDP ratio gradually fell over a period of eight years, from a high of 29.3% in 2000/2001 to 26.0% in 2007/08. However, it has been trending upward since then, reflecting factors such as significantly

Figure 4: Ratio of Net Debt to Gross Domestic Product (GDP), 2001/02–2019/20

Source of data: March 31, 2016, and March 31, 2017, Province of Ontario Annual Reports—Financial Statement Discussion and Analysis, 2017 Ontario Budget, and 2017 Ontario Economic Outlook and Fiscal Review



* Beginning in 2014/15, the Office of the Auditor General has made an adjustment to the net pension asset in accordance with Canadian Public Sector Accounting Standards. This adjustment was not made in the government's presentation of the Province's consolidated financial statements.

increased borrowing to fund annual deficits and infrastructure spending. As well, there was the significant jump in the ratio in 2014/15 after properly accounting for the net pension assets of the OTPP and the OPSEUPP. Ontario's net-debt-to-GDP rose from approximately 26% prior to the 2008/09 recession to approximately 39.6% in 2016/17. We project Ontario's net debt will increase by \$49 billion over the next three years to approximately \$363 billion in 2019/20, resulting in the net-debt-to-GDP ratio rising to 40.0%. In contrast, the government's 2017 Fall Economic Statement projected a small decline in the net-debt-to-GDP ratio, to 37.0% by 2019/20, because that estimate does not reflect the net pension asset and Fair Hydro Plan adjustments.

We noted in our previous annual reports that many experts believe when a jurisdiction's net-debt-to-GDP ratio rises above 60%, that jurisdiction's fiscal health is at risk and is vulnerable to unexpected economic shocks. Of significance, the Financial Accountability Office in its report on the Long-term Budget Outlook 2017, released October 19, 2017,

projected Ontario's net-debt-to-GDP ratio would rise to 63% by 2050/51, significantly above today's ratio of 39.6%.

We also noted it is somewhat of an oversimplification to rely on just one measure to assess a government's borrowing capacity, because that measure does not take into account Ontario's share of federal and municipal debts. If the Province's share of those debts was included in its indebtedness calculations, the net debt would be much higher. However, consistent with debt-measurement methodologies used by most jurisdictions, throughout our analysis we have focused only on the provincial government's direct net debt.

Figure 5 shows the net debt of Ontario compared to other provinces and the federal government, along with their respective ratios of net debt to GDP. Generally, the western provinces have a significantly lower net-debt-to-GDP ratio than Ontario and the Atlantic provinces, and Quebec has a significantly higher ratio than Ontario.

Figure 5: Net Debt and the Net-Debt-to-GDP Ratios of Canadian Jurisdictions, 2016/17

Sources of data: Province of Ontario Annual Report and Consolidated Financial Statements; Annual Reports and Consolidated Financial Statements of other provincial jurisdictions; Federal Budgets and budget updates; budgets of provincial jurisdictions; and the Office of the Auditor General of Ontario

	Net Debt (\$ million)	Net Debt to GDP (%)
AB	8,901	2.9
SK	10,192	13.3
BC	37,795	14.4
Federal	631,899	31.2
MB	22,693	33.7
PEI	2,172	34.0
NS	14,955	36.4
ON	314,077	39.6
NB	13,827	41.1
NL	13,598	44.6
QC	185,214	47.2

Ontario's government committed to reducing net-debt-to-GDP ratio to its pre-recession level of 27% by 2029/30. However, the government's commitment does not take into account the overstatement of the pension assets of the OTPP and the OPSEUPP and the accounting for the projected costs of the Fair Hydro Plan.

7.3 Other Measures to Assess Government Debt Levels

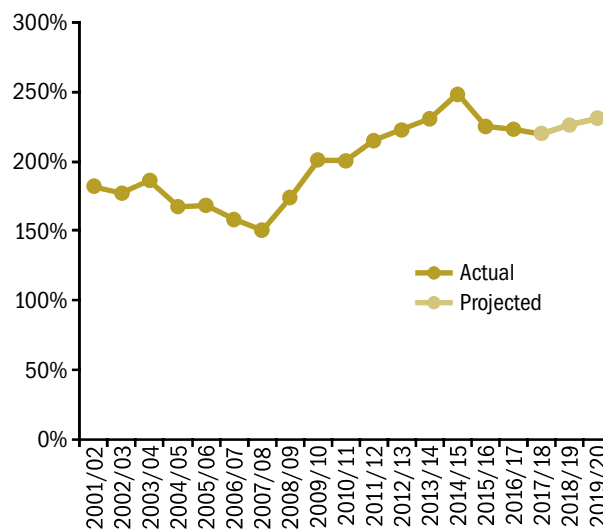
7.3.1 Ratio of Net Debt to Total Annual Revenues

Another useful measure of government debt is the ratio of net debt to total annual revenues, an indicator of how much time it would take to eliminate the debt if the Province spent all of its revenues on nothing but debt repayment. For instance, a ratio of 250% indicates that it would take 2.5 years to eliminate the provincial debt if all revenues were devoted exclusively to it.

As shown in **Figure 6**, this ratio declined from about 183% in 2000/2001 to about 150% in

Figure 6: Ratio of Net Debt as Percentage of Total Annual Revenue, 2001/02–2019/20

Sources of data: March 31, 2017, Province of Ontario Consolidated Financial Statements; 2017, 2016, 2015, 2009 and 2008 Ontario Budgets; 2017 Ontario Economic Outlook and Fiscal Review; and Office of the Auditor General of Ontario



2007/08, reflecting the fact that the Province's net debt grew at a slower pace than annual provincial revenue. However, the ratio has increased steadily since 2007/08, and expected to reach 229.5% by 2019/20 before beginning to fall. This increasing ratio of net debt to total annual revenue indicates the Province's net debt has relatively less revenue to support the debt burden.

7.3.2 Ratio of Interest Expense to Revenue

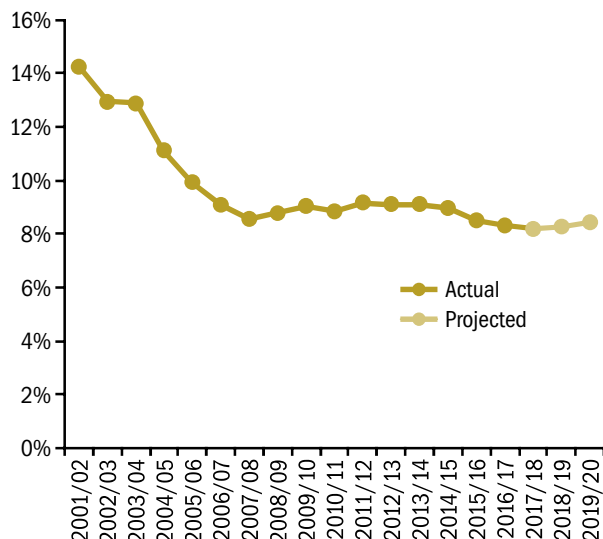
Increases in the cost of servicing total debt, or interest expense, can directly affect the quantity and quality of programs and services that government can provide; the higher the proportion of government revenues going to pay interest costs on past borrowings, the lower the proportion available for spending in other areas.

The interest-expense-to-revenue ratio illustrates the extent to which servicing past borrowings takes a greater or lesser share of total revenues.

As **Figure 7** shows, rates have been at historic lows since the beginning of this decade, and the actual interest-expense-to-total revenues ratio

Figure 7: Ratio of Interest Expense to Revenue, 2001/02–2019/20

Sources of data: March 31, 2017, Province of Ontario Consolidated Financial Statements; 2017, 2016, 2015, 2009 and 2008 Ontario Budgets; 2017 Ontario Economic Outlook and Fiscal Review; and Office of the Auditor General of Ontario



held steady at around 9.0% from 2010/11 to 2014/15. In 2016/17, the government consolidated the broader public sector on a line-by-line basis, which increased both interest expense and revenue reported in the Province's consolidated financial statements beginning in 2015/16. By including the broader public sector, the ratio has decreased to 8.5% in 2015/16. The ratio stood at 8.3% in 2016/17 and is projected to be 8.3% in 2019/20. This means approximately 8.3 cents of every dollar in revenue that the government collects will go toward paying interest on debt by 2019/20.

The Province's debt also exposes it to further risks, the most significant being interest-rate risk. As noted above, interest rates are currently at record low levels, enabling the government to keep its annual interest expense relatively steady even as its total borrowing has increased significantly. However, interest rates began to rise this year and there is an increasing risk that the government will have considerably less flexibility to provide public services such as health care and education, because a higher proportion of its revenues will be required to pay interest on the Province's outstanding debt.

As was noted in last year's annual report, the government has mitigated its interest-rate risk to some extent by increasing the weighted average term of its annual borrowings in order to take advantage of the current low rates. However, the Bank of Canada raised its key lending rate twice in 2017. When the government refinances debt at a higher interest rate than the rate paid on the maturing debt, then the average interest expense on the government's debt will go up. This means more money will go towards interest expense and therefore will increase the annual deficit.

The ratio of interest-expense-to-revenue is expected to continue to increase in the near future as more interest will be paid on the accumulation of debt issued to fund the Fair Hydro Plan transactions, indicating the government will have less flexibility to respond to changing economic circumstances. Past governments' borrowing and debt-servicing decisions mean a growing portion of revenues will not be available for other current and future government programs.

7.4 Consequences of High Indebtedness

Our commentary last year highlighted the consequences for the Province of carrying a large debt load—and the same observations continue to be relevant this year. They include the following:

Debt-servicing costs cut into funding for other programs: As debt grows, so do interest costs. As interest costs consume a greater proportion of government resources, there is less to spend on other things. To put this “crowding-out” effect into perspective, the government currently spends more on debt interest than on post-secondary education.

Greater vulnerability to interest-rate increases: Ontario has been able to keep its annual interest expense relatively steady, even as its total borrowing has increased significantly. For example, it was paying an average effective interest rate of about 8.4% in 1999/2000, but that dropped to 3.5% in 2016/17. However, if interest rates start to

rise again, the government will have considerably less flexibility to provide public services as it will have to devote a higher proportion of its revenue to interest payments.

Potential credit-rating downgrades could lead to higher borrowing costs: Prepared by specialized agencies, credit ratings assess a government's creditworthiness largely based on its capacity to generate revenue to service its debt. They consider such factors as a government's economic resources and prospects, industrial and institutional strengths, financial health, and susceptibility to major risks. A credit rating affects the cost of future government borrowing, with a lower rating indicating that an agency believes there is a relatively higher risk that a government will default on its debt. Accordingly, investors will lend to that government only in return for a greater risk premium, in the form of higher interest rates. A rating downgrade could also shrink the potential market for a government's debt, because some investors will not hold debt below a certain rating.

7.5 Final Thoughts on Ontario's Debt Burden

We recognize that, ultimately, decisions about how much debt the Province should carry, and the strategies to pay down that debt, are questions of government policy. However, as we observed last year, this should not prevent the government from providing information to promote a greater understanding of the issue and clarify the choices it makes around provincial debt.

We noted that government debt has been described as a burden on future generations, especially debt used to finance operating deficits (debt used to finance infrastructure is more likely to leave behind tangible capital assets that benefit future generations). In the 2017 Budget, the government set an interim net debt-to-GDP ratio target of 35% by 2023/24, and restated its commitment to reduce the net debt-to-GDP ratio to its pre-recession level

of 27% by 2029/30. Meeting its 2029/30 commitment is based on the three key assumptions:

- ongoing balanced budgets, on average, over the next 12 years;
- future capital spending as laid out in the long-term infrastructure plan; and
- the continuation of strong economic growth.

The Financial Accountability Office of Ontario's September 6, 2017, Commentary, titled *Ontario's Debt Reduction Based on Unlikely Assumption*, noted that "if any of these relatively optimistic assumptions fall short of expectations, the government's 27% net debt-to-GDP target would not be achieved." The commitment does not take into account the effects of the proper accounting treatment of the OTPP and the OPSEUPP assets and accounting for the costs of the Fair Hydro Plan. If the government were to account for these items as recommended by our Office, balanced budgets are unlikely over the next few years, and the fulfilment of the government's net-debt-to-GDP reduction commitment is even more unlikely.

We offer one final observation: despite the government's commitment to reduce the net debt-to-GDP ratio, there is as yet no discussion around the repayment of debt.

RECOMMENDATION 7

We recommend that in order to address the Province's growing total debt burden, the government work toward the development of a long-term total-debt reduction plan linked to its target of reducing the net debt-to-GDP ratio to its pre-recession level of 27% as measured using proper accounting for net pension assets and the projected costs of the Fair Hydro Plan. The government should also discuss publicly how it plans to pay down the debt.

MINISTRY OF FINANCE RESPONSE

The 2017 Budget and the 2017 Fall Economic Statement stated that the government continues to maintain a target of reducing the net

debt-to-GDP ratio to its pre-recession level of 27%, currently projected for 2029/30, together with an interim target of 35% by 2023/24. From 2017/18 onwards, the balanced budget environment will limit increases in debt to the difference between annual investments in infrastructure improvements and the amortization of such investments.

The government's long-term infrastructure plan to invest about \$190 billion over 13 years, starting in 2014/15, will contribute to the growth of the economy. The Centre for Spatial Economics found that for every \$1 spent on public infrastructure, GDP increases by \$6, on average, in the long term.

Therefore, while overall debt will rise to fund these infrastructure investments, measurements of relative debt such as the net debt-to-GDP ratio, a recommended indicator by the Public Sector Accounting Board, will gradually diminish due to the Province's GDP increasing at a faster rate than net debt. This will allow the Government to continue to move towards its 27% net debt-to-GDP target.

8.0 Other Significant Accounting and Audit Issues

8.1 Earlier Finalization of the Province's Consolidated Financial Statements

Historically, the Public Accounts have been released in either late August or September of each year. However, the government has indicated it would like to have an earlier release date for the Public Accounts in the future. We support a more timely publication of the Province's financial results. However, our ability to support this initiative depends on the Province's ability to provide us with sufficient and appropriate audit evidence such that we can assess the reasonability of the consolidated financial statements.

Canadian PSAS recognize that there is often a trade-off between the timeliness of producing financial statements to provide relevant information, and the reliability of the information reported in the financial statements. A significant change to the timing of the release of Public Accounts requires management to set the groundwork and apply sufficient resources for it to succeed in ensuring that appropriate schedules and other documentation are available for audit. An earlier preparation and audit timeline requires co-ordination between the preparer and auditor of the financial statements.

For example, the need for reasonable corporations tax and personal income tax estimates at an earlier date is an audit concern that the Province will need to address in order for our audit opinion to be issued sooner. Corporations tax and personal income tax revenues combined make up approximately 50% of the Province's total tax revenues, and 33% of total revenues. Both corporations tax and personal income tax revenues are based on, among other factors, an estimate of current-year tax assessments. These estimates are based on tax-filing data provided by the federal government to the Province. This data has historically not been available before July. Without this data, there is a significant challenge to accurately estimating (and auditing) corporations tax and personal income tax revenue. The Ministry of Finance needs an alternative to the current tax revenue estimation process it uses in order to prepare the Province's consolidated financial statements earlier in the year.

RECOMMENDATION 8

We recommend that the Office of the Provincial Controller undertake thorough planning involving all stakeholders, including Treasury Board Secretariat, ministries and provincial government agencies, to identify the barriers and key areas to be addressed to achieve earlier finalization of the Province's consolidated financial statements, including the estimation risks associated with corporations tax and personal income tax revenues.

TREASURY BOARD SECRETARIAT RESPONSE

Treasury Board Secretariat and the Ministry of Finance are supportive of the timely delivery of the Public Accounts.

The Office of the Provincial Controller will work closely with the Office of the Auditor General to identify audit issues early and to ensure that stakeholders are engaged in discussions regarding risks and resolution. The Office of the Provincial Controller will collaborate with the Office of the Auditor General to support the timely delivery of the Public Accounts.

The Province will work with the Canada Revenue Agency on this recommendation, as reporting Personal and Corporate taxation revenues is highly dependent on information it provides.

8.2 The Restatements in the 2016/17 Consolidated Financial Statements

8.2.1 Introduction

In preparing the Province's 2016/17 consolidated financial statements, the government also restated the prior year comparative figures for 2015/16. Financial restatements can result from a number of factors such as the retroactive application of a new accounting standard, correction of an error due to a misapplied accounting policy, or a reclassification of comparative figures to conform to the current year presentation. Note 16 to the Province's 2016/17 consolidated financial statements describe the four areas impacted by the restatements.

Restatements of previously issued financial statements typically occur for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework. However, in the Province's 2016/17 consolidated financial statements, the government made a number of restatements that further departed from Canadian PSAS. We found that the magnitude of

the misstatements and the departures from the standards established by the Public Sector Accounting Board could influence decisions made by the users of the Province's consolidated financial statements, and this led to the qualified audit opinion on the 2016/17 consolidated financial statements.

8.2.2 Accounting for Net Pension Assets of Jointly Sponsored Pension Plans

In the previously issued 2015/16 consolidated financial statements, the government had correctly recorded an adjustment to recognize a valuation allowance against the pension asset it had recorded for the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP). We agreed with this accounting treatment as the government has neither unilateral control, nor access to the surplus assets of these jointly sponsored pension plans until an agreement is in place with the joint sponsor to allow the government to unilaterally reduce minimum contributions or withdraw plan surpluses. To date, no such agreement exists.

However, the government did not record the same adjustment in the 2014/15 comparative figures on the 2015/16 financial statements, and this led to the qualified audit opinion on the Province's March 31, 2016, consolidated financial statements. In addition to the magnitude of the financial impact, we were concerned that by not restating the 2014/15 comparative figures, the government demonstrated a lack of transparency on the nature of the adjustment of the pension assets as a correction of an error in prior periods.

Subsequent to the publication of the 2015/16 Public Accounts, the government decided to change its accounting policy and recognize pension assets in the Province's 2016/17 consolidated financial statements without properly reducing them by way of a full valuation allowance. The valuation allowance that had been recorded to reduce pension assets in 2015/16 was reversed, resulting in the 2015/16 comparative pension assets balances

being restated for the 2016/17 consolidated financial statements. The originally published 2015/16 amounts were correct. The change made resulted in a significant error to the restated 2015/16 comparative figures.

An essential characteristic of an asset, as defined by Canadian PSAS, is that the government must have unilateral control to access the pension assets. It does not have this control. Therefore, a net pension asset related to the OTPP and the OPSEUPP should not be reported in the Province's consolidated financial statements. **Section 3.6.1** in this chapter discusses the accounting in more detail and our recommendations on the proper accounting treatment of the OTPP and the OPSEUPP pension assets in the Province's consolidated financial statements in accordance with PSAS.

8.2.3 Consolidation of the Broader Public Sector, Accounting for Ontario Power Generation and Hydro One

The consolidated financial statements include the financial results of all the ministries and organizations controlled by the government. Whether a government controls an organization from an accounting perspective is a question of judgment that must be determined by reference to the definition established by the Canadian PSAS. Schedule 8 of the consolidated financial statements lists the government business enterprises (GBEs), other government organizations (OGOs) and broader public sector (BPS) organizations controlled by the Province and included in the consolidated financial statements.

Canadian PSAS established two accounting methods for recording the results of the organizations that form part of the government reporting entity in the Province's consolidated financial statements, depending on the nature of an organization. This section discusses the broader public sector, Ontario Power Generation and Hydro One, and in particular, the conditions that resulted in the revised presentation.

Broader Public Sector Properly Consolidated on a Line-by-Line Basis

The Broader Public Sector (BPS) organizations include hospitals, school boards and colleges. Prior to 2016/17, the assets and liabilities of the BPS organizations were consolidated with those of the Province on a line-by-line basis on the consolidated statement of financial position. However, the Province did not apply the same line-by-line consolidation method to the consolidated statement of operations. Instead, the revenues and expenses of the BPS sector were netted against the respective sectors' expenses (for example, Health, Education, etc.).

In the past, we have communicated that in order to comply with Canadian PSAS, all the accounts of the BPS organizations are required to be consolidated on a line-by-line basis.

We noted that the Province decided to fully apply the line-by-line consolidation of the BPS organizations in the Province's 2016/17 consolidated financial statements. As a result of this change, both the 2015/16 comparative period figures and the 2016/17 Budget amounts were appropriately restated.

Proper Recording of OPG and Hydro One's Financial Results Using IFRS

Canadian PSAS include guidelines that define the nature of a government business enterprise (GBE). Fundamentally, a GBE has autonomy and business-oriented objectives. In the normal course of its operations, a GBE should be able to maintain its operations, meet its liabilities and repay its gross debt from revenues received from sources outside of the government reporting entity. GBEs are consolidated under Canadian PSAS using the modified equity approach, and this method reflects the nature of the independently-managed business enterprise.

Both OPG and Hydro One are deemed to be GBEs. Given that a GBE carries on a business, Canadian PSAS prescribe that GBE financial statements should be prepared on the same basis as the private

sector, which is International Financial Reporting Standards (IFRS). In accordance with Canadian PSAS, the financial results of OPG and Hydro One, should be reflected in the Province's consolidated financial statements based on IFRS.

We have commented in the past that the Ontario government chose to use U.S. generally accepted accounting standards (which is not accepted for consolidation in a government's financial statements prepared using Canadian PSAS) and not IFRS as the basis for recording the financial results of OPG and Hydro One. In **Chapter 2** of our *2016 Annual Report*, we indicated that we anticipated that differences between the U.S. generally accepted accounting standards and IFRS could become material in the future. We recommended then that the Province include the financial results for OPG and Hydro One in the Province's consolidated financial statements determined based on the IFRS framework. We noted that the Province decided to change its accounting policy to comply with Canadian PSAS and record the financial results of Ontario Power Generation and Hydro One using IFRS in the Province's 2016/17 consolidated financial statements.

8.2.4 Improper Recognition of Market Accounts

In the 2016/17 consolidated financial statements, the Province changed its accounting policies to recognize market accounts and rate-regulated assets, which also resulted in the restatement of the Province's 2015/16 comparative financial results.

The market accounts principally track buy and sell transactions between electricity power generators and power distributors. As we outlined in **Section 3.6.2** of this chapter, we disagree with the restatement to record the market accounts on a gross basis, because the government has no access or discretion to use the market account assets for their own benefit; nor does it have an obligation to settle the market account liabilities in the event of default by market participants. The nature of the

market accounts do not meet the characteristics of an asset or liability established by Canadian PSAS and the recognition of these accounts on the consolidated financial statements is a basis for the qualified audit opinion.

8.2.5 Inappropriate Recording of Impact of Rate-Regulated Accounting

In the Province's 2016/17 consolidated financial statements, the Province recognized the rate-regulated assets from an "other government organization," the Independent Electric System Operator (IESO), in its consolidated financial statements, and restated the 2015/16 comparative amounts for this accounting change. We disagree with this restatement. As we outline in **Section 3.7** of this chapter, although it is not specifically stated in the Canadian PSAS, rate-regulated accounting is not permitted for use in financial statements prepared under Canadian PSAS (except for GBEs that report using the IFRS Framework that are included in a government's consolidated financial statements).

8.3 The Affordability Fund Trust

The timing as to when expenses are recorded in the Province's consolidated financial statements is important, and the criteria used to determine when these amounts should be recognized is based on Canadian PSAS.

The Province of Ontario consolidates into its financial statements the financial results of over 300 organizations controlled by the Province. The amounts reflected in the Province's consolidated financial statements for the activities of a controlled organization are net of inter-organizational balances and transactions. This means, for example, that if a ministry transfers funds to an organization that the government controls, the ministry records an expense (decrease in economic resources) while the organization records a revenue (gain in economic resources). These amounts cancel out on consolidation such that no net revenue or

expense is recognized in the consolidated financial statements because the Province, as a whole, has not experienced a change in its overall level of economic resources.

In contrast, if funds are transferred to a non-controlled entity (i.e., independent, third-party) an expense is then recorded in the consolidated financial statements (assuming the eligibility criteria attached to the funds were met by the non-controlled entity).

On March 23, 2017, the Province established an arm's-length trust, the Affordability Fund Trust (Affordability Fund), in consultation with Hydro One and in conjunction with all other Local Distribution Companies (LDCs), as part of the Fair Hydro Plan. The Affordability Fund was formed to provide direct funding to individual electricity customers in need to reduce their future electricity bills up to December 31, 2019. On the same day, the Province transferred \$100 million to the Affordability Fund and recognized this expense in full in the Province's 2016/17 consolidated financial statements.

If the Affordability Fund were determined to be controlled by the Province, the expense would have only been able to be recognized when the actual funds were provided to the specific beneficiaries (that is, the individual electricity customers under Canadian PSAS). As at March 31, 2017, there were no transfers made to beneficiaries. However, the Affordability Fund was set up as an arm's length trust in order to not to be controlled by the Province, and therefore able to record the expense of \$100 million in the Province's 2016/17 consolidated financial statements.

In order to record the expense, the government accepted the trade-off of then giving up control over the spending of \$100 million provided to the Affordability Fund.

Although we acknowledge that accounting for such transfers of funds to non-controlled trusts is an acceptable way under Canadian PSAS to enable the recording of an expense before money is spent, the government has given up control over the management of these funds before funds are provided to

the intended beneficiaries. In the case of the Affordability Fund, it may be years before funds are fully distributed to intended grant recipients.

RECOMMENDATION 9

We recommend that the government avoid establishing arm's length trusts in order to record an expense in its consolidated financial statements before it is necessary, given that it loses the ability to ensure that funds are ultimately provided to the appropriate beneficiaries.

TREASURY BOARD SECRETARIAT RESPONSE

The response received from the Treasury Board Secretariat did not address the recommendation.

9.0 Auditor General Review of the 2018 Pre-Election Report on Ontario's Finances

One of the most significant initiatives to improve the transparency of government financial reporting is the requirement that the government release a report on Ontario's finances in advance of a provincial election.

The *Fiscal Transparency and Accountability Act, 2004* (Act) states, among other things, that in such circumstances as may be prescribed by regulation, the Ministry of Finance shall release a report on Ontario's finances and shall do so before the deadline established by regulation. The purpose of this report is to provide the public with detailed information to enhance its understanding of the Province's estimated future revenues, expenses, and projected surplus or deficit for the next three fiscal years. Ontario election law says the next provincial general election will be held on June 7, 2018.

As required by the Act, the government's Pre-Election Report will provide information on:

- the macroeconomic forecasts and assumptions used to prepare the government's fiscal plan;
- Ontario's estimated revenues and expenses, including estimates of the major components of the revenues and expenses;
- details of the budget reserve; and,
- the ratio of provincial debt to Ontario's gross domestic product.

As required under the Act, the Auditor General must review the report to determine whether it is reasonable, and release an independent report describing the results of her review. Two things must occur before this review can take place:

- The government must prepare a Pre-Election Report covering a defined period of time.
- As per the Act, in such circumstances as may be prescribed by regulation, the Ministry of Finance shall release a report on Ontario's finances and shall do so before the deadline established by regulation.

As of November 7, 2017, a regulation prescribed by Lieutenant Governor in Council has not yet been issued. This regulation is important because it provides our Office with information on when the pre-election report will be available to us for review. The sooner our Office is made aware of the form and timing of issuance of the pre-election report, the better our ability to complete a review prior to the pre-election report deadline.

The Act was created when the fixed general election date was set for the fall of every fourth year. As such, pre-election reports issued by the Ministry of Finance used the budgeted revenue and expense estimates contained within the spring budget of the election year. Now, with the change of the fixed general election date to June of every fourth year, if the pre-election report is based on the same spring budget, this could pose time constraints for us to complete our work.

If the government establishes a regulation under subsection 10(1) of the Act to release a Pre-Election Report, and if the Minister does not release information required by this Act on or before the deadline it sets in a regulation, the Minister shall release

a statement on or before that deadline to explain why the required information was not so released.

We will work closely with the Ministry of Finance and Treasury Board Secretariat in order to allow us to complete the review and issue our report in sufficient time in advance of the June 7, 2018, general election.

RECOMMENDATION 10

We recommend that the government publicly communicate if and when it will file a regulation as outlined under subsection 10(1) of the *Fiscal Transparency and Accountability Act, 2004* confirming that the government will release a Pre-Election Report and the timelines for release of the Report that will be subject to our review under the Act.

TREASURY BOARD SECRETARIAT RESPONSE

Under the *Fiscal Transparency and Accountability Act, 2004*, the government may file a regulation that would require it to release a Pre-Election Report on Ontario's Finances. Should the government file such a regulation, the Auditor General would be required to issue a Statement based on a review following the release of such a Pre-Election Report.

The government remains committed to meeting the legislative requirements of the Act and working constructively with the Office of the Auditor General.

OFFICE OF THE AUDITOR GENERAL RESPONSE

Our concern at the time we went to print with our *2017 Annual Report* was that we may be put in a situation where the government does not allow us sufficient time, as required by Canadian generally accepted auditing standards, to perform the work required to issue a statement on the results of our review of the Pre-Election Report.

10.0 Update on WSIB

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation created by the *Workplace Safety and Insurance Act, 1997* (Act). Its primary purpose is to provide income support and medical assistance to workers injured on the job. The WSIB receives no funding from government; it is financed through premiums on employer payrolls.

Our 2009 *Annual Report* discussed the risk that the growth and magnitude of the unfunded liability (the difference between the value of the WSIB's assets and its estimated financial obligations to pay benefits to injured workers) at that time posed to the WSIB's financial viability, including the ultimate risk of the WSIB being unable to meet its existing and future commitments to provide worker benefits.

At the time, we also urged the government to reconsider the exclusion of the WSIB's financial results from the Province's consolidated financial statements, particularly if there were any risks that the Province might have to provide funding to ensure the WSIB remained viable. The government excludes WSIB's financial results because it is classified as a "trust." However, given the WSIB's significant unfunded liability and various other factors, we questioned whether the WSIB operates like a true trust. Including the WSIB in the government's consolidated financial statements would have a significant impact on the government's fiscal performance.

As of June 30, 2010, the WSIB's unfunded liability had grown to almost \$13 billion. In September 2010, the WSIB announced an independent funding review to obtain advice on how to best ensure the long-term financial viability of Ontario's workplace safety and insurance system. The May 2012 report contained a number of recommendations, in particular calling for a new funding strategy for the WSIB with the following key elements:

- realistic assumptions, including a discount rate based on the best actuarial advice;

- moving the WSIB as quickly as feasible beyond a "tipping point" of a 60% funding Sufficiency Ratio (a tipping point is a crisis in which the WSIB could not generate sufficient funds to pay workers' benefits within a reasonable time frame and by reasonable measures); and
- putting the WSIB on course to achieve a 90%–110% funding Sufficiency Ratio within 20 years.

In response to our concerns and to the recommendations of the report, the government passed Regulation 141/12 under the Act in June 2012. Effective January 1, 2013, it required the WSIB to ensure it meets the following funding Sufficiency Ratios by specified dates:

- 60% on or before December 31, 2017;
- 80% on or before December 31, 2022; and
- 100% on or before December 31, 2027.

The government also passed Ontario Regulation 338/13 in 2013. It came into force January 1, 2014, and changed the way the WSIB calculates the funding Sufficiency Ratio by changing the method used to value its assets and liabilities. Our Office concurred with this amendment.

The WSIB issues quarterly Sufficiency Reports and an audited Sufficiency Report to stakeholders annually. As of December 31, 2016, under Regulation 141/12 as amended by Regulation 338/13, the WSIB reported a Sufficiency Ratio of 87.4% (in 2015, the Sufficiency Ratio was 77.9%). This means the WSIB has already achieved its December 31, 2022 funding requirement.

The WSIB now incorporates its annual update of the Sufficiency Plan within the economic statement, in which it describes the measures taken to improve its funding Sufficiency Ratio. The most recent plan was announced at WSIB's Annual General Meeting held on September 20, 2017, and is also available on the WSIB website.

The WSIB's operational and financial performance was strong in 2016, as illustrated in **Figure 8**, which provides a summary of the WSIB's operating results and unfunded liability compared to 2015.

Figure 8: Workplace Safety and Insurance Board Operating Results and Unfunded Liability, 2016 and 2015

Source of data: WSIB Financial Statements

	2016 (\$ million)	2015 (\$ million)
Revenue		
Premiums	4,862	4,684
Net investment income	1,497	1,199
	6,359	5,883
Expenses		
Benefit costs	2,747	3,760
Loss of Retirement Income Fund contributions	56	56
Administration and other expenses	431	406
Legislated obligations and commitments	244	263
Remeasurement of employee defined benefit plans	35	(45)
	3,513	4,440
Total Comprehensive Income	2,846	1,443
Less: Non-Controlling Interests	(172)	(152)
Total Comprehensive Income Attributable to WSIB Stakeholders	2,674	1,291
Unfunded Liability	3,925	6,599

The WSIB's continued strong operating performance in 2016 resulted from growth in premium revenues, improved return-to-work outcomes and better-than-expected investment returns (6.3% versus the target of 5.25%).

As a result of commitments by the government and the WSIB to address the unfunded liability and the progress the WSIB has made so far, we support the continued classification of the WSIB as a trust for the 2016/17 fiscal year and, therefore, the exclusion of the unfunded liability from the Province's liabilities.

11.0 Ongoing Accounting Standards Matters

Canadian PSAS are the most appropriate for the Province to use in preparing its consolidated financial statements. This ensures that information provided by the government about its surplus or the deficit is fair, consistent and comparable to data

from previous years, allowing legislators and the public to assess the government's management of the public purse. It is worth noting that Ontario's provincial budget is also prepared on the same basis as its consolidated financial statements.

However, the Public Sector Accounting Board (PSAB) faces challenges in reaching a consensus among its various stakeholders, including financial statement preparers and auditors, during the development and update of standards for the public sector.

We discuss two significant accounting issues: Financial Instruments and Rate-Regulated Accounting in government business enterprises that have posed a significant challenge to PSAB over the past few years. Their final accounting-standard determination may affect the way the Province accounts for these items, and may have a significant impact on the Province's reported financial results.

11.1 Financial Instruments

Financial instruments include provincial debt and derivatives such as currency swaps and foreign-exchange forward contracts. PSAB's project to develop a new standard for reporting financial instruments began in 2005, with a key issue being whether changes in the fair value of derivative contracts held by governments should be reflected in their financial statements and, in particular, whether such changes should affect a government's annual surplus or deficit.

In March 2011, PSAB approved a new public-sector accounting standard on financial instruments, effective for fiscal periods beginning on or after April 1, 2015. The new standard provides guidance on the treatment of government financial instruments, and is similar to comparable private-sector standards.

One of its main requirements is for certain financial instruments, including derivatives, to be recorded at fair value, with any unrealized gains or losses on these instruments recorded annually in a new financial statement of re-measurement of gains and losses.

Some Canadian jurisdiction preparers, including Ontario, do not support the introduction of these fair-value re-measurements and the recognition of unrealized gains and losses. Ontario's view is that it uses derivatives solely to manage foreign currency and interest-rate risks related to its long-term-debt holdings, and that it has both the intention and ability to hold these derivatives until the debts associated with them mature.

Accordingly, re-measurement gains and losses on the derivatives and their underlying debt would offset each other over the total period that such derivatives are held, and therefore would have no real economic impact on the government.

The government argues that recording paper gains and losses each year would force the Province to inappropriately report the very volatility that the derivatives were acquired to avoid. This, in its view, would not reflect the economic substance of government financing transactions and would not

provide the public with transparent information on government finances.

In response to governments' concerns, PSAB committed to reviewing the new financial instruments standard by December 2013. PSAB completed its review of *Section PS 2601, Foreign Currency Translation*, and *Section PS 3450, Financial Instruments*, and in February 2014 confirmed the soundness of the principles underlying the new standard.

PSAB deferred the effective date for these new standards to fiscal years beginning on or after April 1, 2016. In 2015, however, PSAB further extended the effective date for the new standard to April 1, 2019, for senior governments, to allow further study of reporting options for these complex financial instruments.

Since February 2016, staff with PSAB have been consulting with the government and not-for-profit stakeholders on implementation issues of the financial instruments standard. The senior government community has communicated the need for a hedge accounting option during these consultations. PSAB noted that its staff, in collaboration with stakeholders, has identified certain timing issues in the new financial-instruments standard that may impact a government's annual surplus or deficit in a manner that is unrepresentative of the underlying transactions. PSAB observed that the International Public Sector Accounting Standards Board (IPSASB) has released a Financial Instruments Exposure Draft that builds upon the private sector's best practices in accounting for financial instruments under International Financial Reporting Standards. PSAB has been following the work of IPSASB whose proposed financial instrument standard includes a hedging option. PSAB noted it is considering using this standard. PSAB also noted some stakeholders expressed concerns about the volatility of net debt of governments on recording derivative instruments at fair value. PSAB noted that while this matter is not within the scope of investigating the hedge accounting option, if PSAB's stakeholders are in favour of the IPSASB proposal, PSAB would consider the implications for net debt in finalizing the hedge accounting requirements.

We continue to recommend ongoing dialogue between our Office and the Office of the Provincial Controller to review areas of common concern as the PSAB reassesses the standard in preparation for implementing it on April 1, 2019.

11.2 Rate-Regulated Accounting

Rate-regulated accounting was developed to recognize the unique nature of entities, such as electric utilities, whose rates are regulated by an independent regulator in most regulatory frameworks. In general, it allows the deferral of revenue and expenses to future years. The regulator often allows the entity to recover certain current-year costs from the ratepayer in future years, and these deferred costs are typically set up under rate-regulated accounting as assets on the entity's statement of financial position. Under normal accounting principles, these costs would be expensed in the year incurred. We have concerns about the appropriateness of recognizing rate-regulated assets and liabilities, including those of government business enterprises in the Province's consolidated financial statements. However, the absence of rate-regulated accounting would have considerable impact on those entities that have followed it for many years where it is still permitted under Canadian PSAS.

Rate-regulated accounting is used by two of the Province's government-controlled business enterprises, Ontario Power Generation (OPG) and Hydro One whose rates to customers are approved by the Ontario Energy Board, a government-established regulator. Rate-regulated accounting treatment is currently allowable under Canadian generally accepted accounting principles for government business enterprises. Rate-regulated accounting provisions outline the need for an independent, third-party regulator to set rates. We note that since the Ontario government controls both the regulator and the major regulated entities, it has significant influence on which costs Hydro One and OPG will recognize in a given year. This could ultimately affect both electricity rates and the annual deficit or surplus reported by the government.

In our previous annual reports, we outlined that the era of rate-regulated accounting appeared to be ending for jurisdictions like Canada as they were converting to International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB), in 2012. Our comments were based on the fact that in January 2012 Canada's Accounting Standards Board (AcSB) reaffirmed that all government business enterprises should prepare their financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2012. At that time, IFRS standards did not include accounting provisions that addressed rate-regulated activities and so, by default, IFRS standards did not permit rate-regulated accounting.

However, the rate-regulated accounting landscape has continued to evolve since then. Efforts to harmonize U.S. generally accepted accounting policies (U.S. GAAP) and IFRS were in place as Canada converted to IFRS in 2012. At that time, U.S. GAAP allowed for, and continues to allow for, rate-regulated accounting. The appropriateness of rate-regulated accounting has been discussed as part of the efforts to harmonize U.S. GAAP and IFRS. As these discussions were taking place, Canada's AcSB granted a one-year extension in March 2012 to the mandatory IFRS changeover date for entities with qualifying rate-regulated activities. Multiple one-year extensions to defer adoption of IFRS by these entities followed over the next few years.

An interim IFRS standard was issued in January 2014 in an attempt to ease the adoption of IFRS for rate-regulated entities by allowing them to continue to apply existing policies for their deferred rate-regulated balances upon adoption of IFRS starting on January 1, 2015. Essentially, the interim standard provides a first-time adopter of IFRS with relief from having to de-recognize their rate-regulated assets and liabilities until the comprehensive review on accounting for such assets and liabilities is completed by the IASB. The result of this review and the determination of whether rate-regulated accounting will be allowed, for example, in government business enterprises on an ongoing basis as opposed to an interim basis, is uncertain at this time.

In 2017, the Auditor General of British Columbia qualified the Province of British Columbia's consolidated financial statements because the government has directly impacted the setting of electricity rates by not allowing BC Hydro to recover its costs of service. The Office of the Auditor General of British Columbia's September 2017 report titled *Understanding Our Audit Opinion on BC's 2016/17 Financial Statements* states: "Even though B.C. has an independent third-party regulator, government has issued a number of directions that the regulator must follow in the rate setting process. In effect, because government brings the accounting results of BC Hydro into its Summary Financial Statements (SFS), government's directions are impacting its own bottom line."

We will continue to monitor developments impacting the use of rate-regulated accounting in government business enterprises going forward to assess its impact on Ontario's consolidated financial statements.

12.0 Public Sector Accounting Board Initiatives

This section outlines some additional items that PSAB has been studying over the past year that might affect the preparation of the Province's consolidated financial statements in the future.

12.1 Concepts Underlying Financial Performance

PSAB's existing conceptual framework is a set of interrelated objectives and fundamental principles that support the development of consistent accounting standards. Its purpose is to instill discipline into the standard-setting process to ensure that accounting standards are developed in an objective, credible and consistent manner that serves the public interest.

In 2011, PSAB formed the Conceptual Framework Task Force in response to concerns raised by several

governments regarding current and proposed standards which they contend cause volatility in reported results and distort budget-to-actual comparisons. The task force's objective was to review the appropriateness of the concepts and principles in the existing conceptual framework for the public sector.

The task force's first step was to seek input from stakeholders on the building blocks of the conceptual framework; these will form the basis for evaluating the existing concepts underlying the measurement of financial performance. To this end, the task force issued two consultation papers: *Characteristics of Public Sector Entities* and *Measuring Financial Performance in Public Sector Financial Statements*.

In March 2015, the task force issued a third consultation paper that proposed a new reporting model and draft principles on public-sector characteristics, financial statement objectives, qualitative characteristics, elements, recognition, measurement and presentation. The comment period ended in August 2015.

The task force is currently developing a statement of principles that will take into account input received from the three Consultation Papers, and will propose a revised conceptual framework and reporting model for public-sector entities. PSAB expects to issue a statement of principles in 2018.

12.2 Asset Retirement Obligations

The objective of this project is to develop a standard that addresses the reporting of legal obligations associated with the retirement of long-lived tangible capital assets currently in productive use. For example, there may be obligations associated with decommissioning an electricity generating facility.

In August 2014, PSAB issued a statement of principles that proposed a new section on retirement obligations associated with tangible capital assets controlled by a public-sector entity. The comment period ended in November 2014; based on the feedback received, PSAB issued an exposure draft

in March 2017. The main features of the Exposure Draft are:

- A retirement obligation should be recognized when there is a legal obligation to incur retirement costs in relation to a tangible capital asset and a reasonable estimate can be made.
- The recognition of an asset retirement obligation will increase the net debt reported by a public-sector entity.
- Upon initial recognition, the entity would increase the carrying amount of the related tangible capital asset by the same amount as the liability. However, if the related asset is no longer in productive use, or if the related asset is not recognized for accounting purposes, these costs would be recorded as an expense.
- The cost included in the carrying amount of the tangible capital asset should be allocated to expense in a rational and systematic manner. This could include amortization over the remaining useful life of the related tangible capital asset, or a component thereof.
- The estimate of a liability for retirement obligation should include costs directly attributable to retirement activities, including post-retirement operation, maintenance and monitoring.
- A present value technique is often the best method with which to estimate the liability.
- The carrying amount of the liability for a retirement obligation should be reviewed at each financial reporting date.
- Subsequent re-measurement of the liability can result in either a change in the carrying amount of the related tangible capital asset or an expense.

PSAB accepted feedback on these proposals until June 15, 2017.

12.3 Revenue

Two major sources of government revenue—government transfers and tax revenue—are addressed in the sections *PS 3410, Government Transfers*

and *PS 3510, Tax Revenues* of the Canadian PSAS. However, PSAS do not specifically address other revenues.

In September 2011, PSAB approved an amended project proposal on revenues to address the limited guidance on revenues that are common in the public sector. PSAB did not initiate the project to review the existing revenue standards; rather, it aimed to put in place overarching guidance to address questions about when revenues are recognized, and how they are measured and presented in the financial statements.

The purpose of the project is to expose a new section on revenues that would apply to public-sector entities that follow PSAS.

Following the publication of a statement of principles in 2013, PSAB issued an exposure draft for public comment earlier this year.

The exposure draft:

- focuses on two main areas of revenue:
 - exchange transactions; and
 - unilateral (non-exchange) transactions
- notes the presence of performance obligations for the public-sector entity as the distinguishing feature of an exchange transaction;
- defines performance obligations as enforceable promises to provide goods or services to a payor;
- specifies that revenue from an exchange transaction is recognized as or when the public-sector entity's satisfies the performance obligation;
- recognizes that performance obligations may be satisfied at a point in time or over a period of time, depending on which method best depicts the transfer of goods or services to the payor; and
- sets out the requirement that public sector entities recognize unilateral revenues when there is the authority and a past event that gives rise to a claim of economic resources.

PSAB asked stakeholders to submit comments on the exposure draft by August 15, 2017.

12.4 Employment Benefits

In December 2014, PSAB approved an Employment Benefits project to improve the existing PSAS sections by taking into account changes in the related accounting concepts and new types of pension plans that were developed since the existing sections were issued decades ago. The project aims to review the existing sections, *PS 3250 Retirement Benefits* and *PS 3255 Postemployment Benefits, Compensated Absences and Termination Benefits*. The first phase of the project will focus on measurement issues such as the deferral of experience gains and losses and discount rates. The second phase will address non-traditional pension plans such as shared-risk plans as well as other important topics such as multi-employer defined-benefit plans and vested sick-leave benefits.

In December 2016, PSAB began the first phase of the project by issuing an invitation to comment on the deferral of actuarial gains and losses. Governments and other public sector entities need to make significant assumptions when valuing pension plan obligations and plan assets. Actuarial gains and losses measure the differences between these assumptions and the plans' experience, plus any updates to the assumptions. In the past, it was common accounting practice in Canada to defer such gains and losses over an extended period of time. However, over the past decade, other accounting frameworks in Canada have moved towards an immediate recognition approach. The invitation to comment seeks input from stakeholders as to whether deferral is still an appropriate choice in the public sector. Proponents of deferrals point to the fact that this approach avoids creating volatility in the reported results and facilitates budget-to-actual comparison. Proponents of the immediate recognition approach believe that it promotes accountability by providing users of the financial statements with the most relevant information.

The next step in the process is an invitation to comment on discount rates is expected to be approved by the end of 2017.

13.0 Statutory Matters

Under section 12 of the *Auditor General Act*, the Auditor General is required to report on any Special Warrants and Treasury Board Orders issued during the year. In addition, section 91 of the *Legislative Assembly Act* requires that the Auditor General report on any transfers of money between items within the same vote in the Estimates of the Office of the Assembly.

13.1 Legislative Approval of Expenditures

Shortly after presenting its budget, the government tables detailed Expenditure Estimates in the Legislative Assembly outlining, on a program-by-program basis, each ministry's planned spending. The Standing Committee on Estimates (Committee) reviews selected ministry estimates and presents a report on this review to the Legislature. Orders for Concurrence for each of the estimates selected by the Committee, following a report by the Committee, are debated in the Legislature for a maximum of two hours before being voted on. The estimates of those ministries that are not selected are deemed to be passed by the Committee, reported to the Legislature, and approved by the Legislature.

After the Orders for Concurrence are approved, the Legislature still needs to provide its final approval for legal spending authority by approving a *Supply Act*, which stipulates the amounts that can be spent by ministries and legislative offices, as detailed in the estimates. Once the *Supply Act* is approved, the expenditures it authorizes are considered to be Voted Appropriations. The *Supply Act, 2017*, which pertained to the fiscal year ended March 31, 2017, received Royal Assent on March 30, 2017.

The *Supply Act* does not receive Royal Assent until after the start of the fiscal year—and sometimes even after the related fiscal year is over—so

the government usually requires interim spending authority prior to its passage. For the 2016/17 fiscal year, the Legislature passed two acts allowing interim appropriations—the *Interim Appropriation for 2016–2017 Act, 2015* (Interim Act) and the *Supplementary Interim Appropriation for 2016–2017 Act, 2016* (Supplementary Act). These two Acts received Royal Assent on December 10, 2015, and December 8, 2016, respectively, and authorized the government to incur up to \$127.1 billion in public-service expenditures, \$4.4 billion in investments, and \$219.5 million in legislative office expenditures. Both acts were made effective as of April 1, 2016, and provided the government with sufficient authority to allow it to incur expenditures from April 1, 2016, to when the *Supply Act, 2017* received Royal Assent on March 30, 2017.

Because the legal spending authority under the Interim Act and the Supplementary Act was intended to be temporary, both were repealed when the *Supply Act, 2017*, received Royal Assent. The *Supply Act, 2017*, also decreased total authorized expenditures in investments from \$4.4 billion to \$4.3 billion, and increased total authorized expenditures of the legislative offices from \$219.5 million to \$225.4 million.

13.2 Special Warrants

If the Legislature is not in session, Section 1.0.7 of the *Financial Administration Act* allows for the issuance of Special Warrants authorizing the incurring of expenditures for which there is no appropriation by the Legislature or for which the appropriation is insufficient. Special Warrants are authorized by Orders-in-Council and approved by the Lieutenant Governor on the recommendation of the government.

No Special Warrants were issued for the fiscal year ended March 31, 2017.

13.3 Treasury Board Orders

Section 1.0.8 of the *Financial Administration Act* allows the Treasury Board to make an order authorizing expenditures to supplement the amount of any voted appropriation that is expected to be insufficient to carry out the purpose for which it was made. The order may be made only if the amount of the increase is offset by a corresponding reduction of expenditures to be incurred from other voted appropriations not fully spent in the fiscal year. The order may be made at any time before the government closes the books for the fiscal year. The government considers the books to be closed when any final adjustments arising from our audit have been made and the Public Accounts have been published and tabled in the Legislature.

Even though the *Treasury Board Act, 1991* was repealed and re-enacted within the *Financial Administration Act* in December 2009, subsection 5(4) of the repealed act was retained. This provision allows the Treasury Board to delegate any of its duties or functions to any member of the Executive Council or to any public servant employed under the *Public Service of Ontario Act, 2006*. Such delegations continue to be in effect until replaced by a new delegation. Since 2006, the Treasury Board has delegated its authority for issuing Treasury Board Orders to ministers to make transfers between programs within their ministries, and to the Chair of the Treasury Board for making program transfers between ministries and making supplementary appropriations from contingency funds. Supplementary appropriations are Treasury Board Orders in which the amount of an appropriation is offset by a reduction to the amount available under the government's centrally controlled contingency fund.

Figure 9 summarizes the total value of Treasury Board Orders issued for the past five fiscal years.

Figure 10 summarizes Treasury Board Orders for the fiscal year ended March 31, 2017, by month of issue.

According to the Standing Orders of the Legislative Assembly, Treasury Board Orders are to be

Figure 9: Total Value of Treasury Board Orders, 2012/13–2016/17 (\$ million)

Source of data: Treasury Board

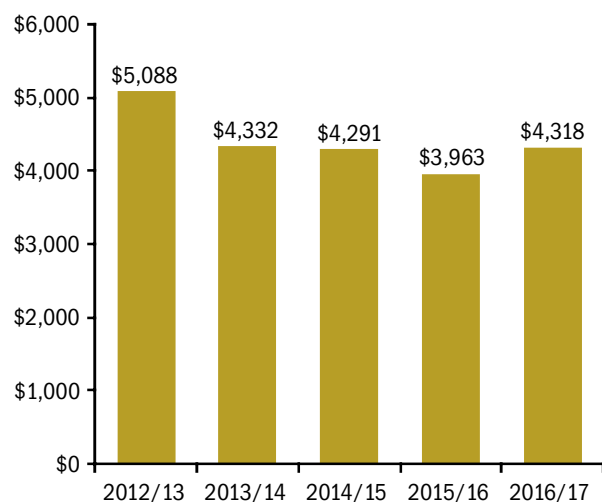


Figure 10: Total Value of Treasury Board Orders by Month Relating to the 2016/17 Fiscal Year

Source of data: Treasury Board

Month of Issue	#	Authorized (\$ million)
April 2016–February 2017	92	1,800
March 2017	60	2,136
April 2017	5	189
May 2017–August 2017	4	193
Total	161	4,318

printed in The Ontario Gazette, together with explanatory information. Orders issued for the 2016/17 fiscal year are expected to be published in The Ontario Gazette in December 2017. A detailed listing of 2016/17 Treasury Board Orders, showing the amounts authorized and expended, is included in **Exhibit 4** of this report.

13.4 Transfers Authorized by the Board of Internal Economy

When the Board of Internal Economy authorizes the transfer of money from one item of the Estimates of the Office of the Assembly to another item

within the same vote, Section 91 of the *Legislative Assembly Act* requires that we make special mention of the transfer(s) in our Annual Report.

Accordingly, **Figure 11** shows the transfers made within Vote 201 with respect to the 2016/17 Estimates.

13.5 Uncollectible Accounts

Under Section 5 of the *Financial Administration Act*, the Lieutenant Governor in Council, on the recommendation of the Minister of Finance and the President of the Treasury Board, may authorize an Order-in-Council to delete from the accounts any amounts due to the Crown that are the subject of a settlement or deemed uncollectible. The amounts deleted from the accounts during any fiscal year are to be reported in the Public Accounts.

In the 2016/17 fiscal year, receivables of \$267 million due to the Crown from individuals and non-government organizations were written off. (The comparable amount in 2015/16 was \$396 million.) The write-offs in the 2016/17 fiscal year related to the following:

- \$64.4 million for uncollectible corporations tax (\$98.9 million in 2015/16);
- \$49.9 million for uncollectible receivables under the Student Support Program (\$50.9 million in 2015/16);
- \$45.9 million for uncollectible receivables under the Ontario Disability Support Program (\$65.3 million in 2015/16);
- \$40.3 million for uncollectible retail sales tax (\$124.2 million in 2015/16);

Figure 11: Authorized Transfers Relating to the Office of the Assembly, 2016/17 Fiscal Year

Source of data: Board of Internal Economy

From:	\$
Item 6 Sergeant at Arms and Precinct Properties	(95,500)
To:	
Item 2 Office of the Clerk	95,500

- \$27.3 million for uncollectible employer health tax (\$20.3 million in 2015/16); and
- \$39.2 million for other tax and non-tax receivables (\$36.4 million in 2015/16).

Volume 2 of the 2016/17 Public Accounts summarizes the write-offs by ministry. Under the accounting policies followed in the preparation of the Province's consolidated financial statements, a provision for doubtful accounts is recorded against accounts receivable balances. Most of the write-offs had already been expensed in the government's consolidated financial statements. However, the actual write-off in the accounts required Order-in-Council approval.

From: [Anna Strathy](#)
To: [Gadi Mayman](#)
Subject: For your review: FAO's Fall 2017 Fiscal Outlook
Date: Thursday, November 23, 2017 1:38:49 PM
Attachments: [image001.png](#)
[2017 EFO - Fiscal Chapter \(OFA Edits V2\).docx](#)

Hi Gadi,

Attached are the OFA's consolidated comments on the FAO's fiscal outlook chapter. Comments are in track changes, but a few that I wanted to flag for you in case it's difficult to read on your phone:

- Alex edited IOD to revenue from 8.1 percent (in the FAO report) to 8.2 percent in 2017-18. Alex commented, "it appears that the FAO does not use BPS-consolidated IOD"
- Correction to total borrowing in 2017-18 (FAO had \$23.8B, instead of \$25.8B)
- The FAO claims that "Beginning 2018-19, borrowing requirements are expected to increase significantly due to higher annual debt maturities, additional funding requirements for the Fair Hydro Plan and rising capital expenditures". John clarifies that our borrowing requirements already factor in OFHP debt burden projections.
- The FAO projects net debt-to-GDP of 41 percent by 2021-22. John comments that the FAO is likely factoring in budget deficits, the 2015-16 Pension adjustment, and additional Fair Hydro Plan debt, all of which is not in line with provincial projections and the advice of the Expert Panel.

We didn't have any comments on the economic outlook chapter. Office of the Budget has asked for our input by 2:00pm. Happy to discuss.

Thanks, Anna

From: Birks, Ryan (MOF) [mailto:Ryan.Birks@ontario.ca]
Sent: Wednesday, November 22, 2017 12:22 PM
To: Ghufuran Tarin (MOF) <Ghufuran.Tarin@ontario.ca>; Anna Strathy <Anna.Strathy@ofina.on.ca>; Usman Zahid <Usman.Zahid@ofina.on.ca>; Cengarle, John (MOF) <John.Cengarle@ontario.ca>; Patel, Lesley (MOF) <Lesley.Patel@ontario.ca>; Patrick Laughton (MOF) <Patrick.Laughton@ontario.ca>; Hosick, Sarah (TBS) <Sarah.Hosick@ontario.ca>; Sohaeb Raashid (MOI) <Sohaeb.Raashid@ontario.ca>; Caleb Lance (MTCS) <Caleb.Lance@ontario.ca>; Manning, Catalina (TBS) <Catalina.Manning@ontario.ca>
Cc: Inglis, Liane (MOF) <Liane.Inglis@ontario.ca>; Selena Esmail (MOF) <Selena.Esmail@ontario.ca>
Subject: FW: FAO's Fall 2017 EFO
Importance: High

Hi All,

As mentioned yesterday, attached are the FAO's draft Economic Outlook and Fiscal Outlook chapters (pw: FAO1616), along with appendix tables in the attached spreadsheet, for review. OB/Framework will lead the consolidation of comments for these chapters.

Can your areas please review and send any comments/edits in tracked changes to myself (with a copy to Liane) by **2pm tomorrow?**

In addition, the FAO has flagged that there's still awaiting FES program spending information. **Patrick and Caleb, can this information please be shared with the FAO as soon as possible?**

Please let me know if you have any questions.

Thank you,
Ryan

From: David West [<mailto:dwest@fao-on.org>]

Sent: November-22-17 11:42 AM

To: Schuurman, Tim (MOF); Lewis, Brian (MOF); Hughes, Karen (TBS)

Cc: Tarin, Ghufuran (MOF); Birks, Ryan (MOF); Luan Ngo; Edward Crummey; Nicolas Rhodes; Hosick, Sarah (TBS); Laughton, Patrick (TBS)

Subject: RE: FAO's Fall 2017 EFO

Importance: High

Tim, Brian Karen

Please find attached drafts of Economic Outlook and Fiscal Outlook chapters from the FAO's upcoming 'Economic and Fiscal Outlook' report.

The chapters are password protected using the same password as in the past.

As in the past, we are on a very tight schedule to enable us to release this report in early December, before the Legislature rises for the holiday break.

However, please note that we are still waiting for the detailed program spending projection consistent with FES (see attached email request from last week). This information is essential to calibrate our models and ensure consistency with the government's projections. If we do not receive that information shortly, we will be forced to proceed with our own estimates which could impact the results and conclusions presented in the report. Please be aware that we will need to be clear with MPPs, during our technical briefing, that we did not receive all the additional background information that we requested. (We did, however, receive the detailed revenue information from FES last week. Thanks)

We are asking for your comments/concerns by end of day Friday (November 24).

Happy to set up a phone call to discuss.

Thanks again for your support and assistance.

David West
Chief Economist

From: David West
Sent: November 20, 2017 10:18 AM
To: Tim Schuurman (Tim.Schuurman@ontario.ca) <Tim.Schuurman@ontario.ca>; Lewis, Brian (MOF) <Brian.Lewis@Ontario.ca>
Cc: Tarin, Ghufuran (MOF) <Ghufuran.Tarin@ontario.ca>; ryan.birks@ontario.ca; Luan Ngo (lngo@fao-on.org) <lngo@fao-on.org>; Edward Crummey <ecrummey@fao-on.org>; Nicolas Rhodes (nrhodes@fao-on.org) <nrhodes@fao-on.org>
Subject: FAO's Fall 2017 EFO

Hello Tim, Brian,

As you are aware, we are preparing our Fall EFO for release in early December.

As in the past, we are planning to send you drafts of the 2 core chapters of the report (economic outlook and fiscal outlook) on Wednesday morning, for your comments. We will also provide the supporting data tables, providing additional details on the projection. The current report follows the basic template of our earlier EFOs, and may be a little shorter.

We would greatly appreciate receiving the Ministry's comments by Friday (November 24) end of day.

Thanks, as always, for your assistance.

David

David West
Chief Economist

fao

Financial
Accountability
Office of Ontario

1. Fiscal Outlook

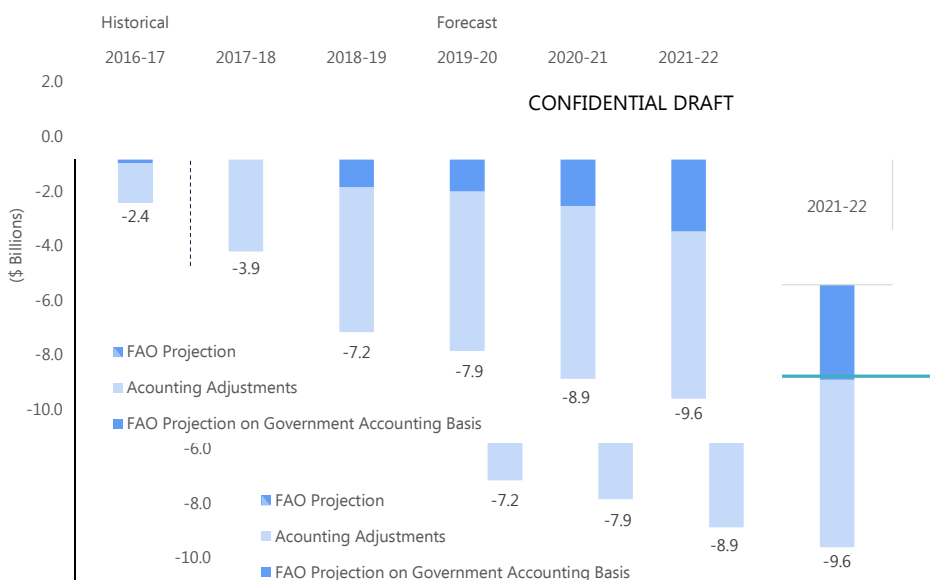
FAO Projects a Return to Significant Budget Deficits

Despite a strong increase in revenues, the FAO is projecting an Ontario budget deficit of \$3.9 billion in 2017-18, entirely the result of the Auditor General of Ontario's (AG) recommended accounting treatment for both the government's Fair Hydro Plan and the net pension assets of jointly-sponsored pension plans.¹

Beyond 2017-18, the FAO is projecting a significant deterioration in the budget deficit due to the loss of time-limited revenues, a more moderate pace of tax revenue growth, and the growing fiscal impact of the AG's recommended accounting framework. By 2021-22, the FAO is projecting an Ontario budget deficit of \$9.6 billion in the absence of any fiscal policy changes.

Ontario Budget Balance

¹ See *The Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability and Value For Money*; Auditor General of Ontario, October 2017 and *Independent Auditor's Report, 2016-17 Consolidated Financial Statements*, Auditor General of Ontario, 2017.



Source: Ontario Public Accounts, 2017 Ontario Economic Outlook and Fiscal Review, and FAO.

In the *2017 Ontario Economic Outlook and Fiscal Review* (also referred to as the Fall Economic Statement or FES), the government projected balanced budgets for 2017-18 through to 2019-20. However, the government's fiscal projection relies on an overly optimistic revenue forecast and does not adopt the AG's recommended accounting framework.

For comparison, under the government's accounting presentation, the FAO projects a small budget surplus for 2017-18 – approximately equal to the government's own budget projection. However, there are a number of time-limited and one-time revenues in 2017-18. Going forward, the loss of these temporary revenues combined with more moderate tax revenue growth results in a return to deficit in 2018-19 and a steady deterioration in the budget deficit over the outlook.

The Accounting Presentation of Ontario's Financial Statements

The government's fiscal plan, as presented in both the 2017 Ontario Budget and Fall Economic Statement, does not adopt the Auditor General's recommended accounting presentation, reducing the transparency and clarity of Ontario's fiscal position.

In addition to the existing disagreement over the appropriate accounting treatment for the government's jointly sponsored pension plans, the AG recently **reported** that the government is not correctly accounting for the full cost of the Fair Hydro Plan in its financial statements.² As a result, the government's fiscal presentation is expected to continue to receive qualified opinions from the AG.

Commented [KK1]: There is no mention of the findings of the independent Pension Asset Expert Advisory Panel. Even if the FAO disagrees with the findings there should be a reference that the Government has followed the Panel's recommendation in accounting for pension assets.

Revenue Outlook

The FAO is projecting average annual revenue growth of 3.1 per cent over the forecast. In 2017-18, revenues are supported by strong growth in taxes, as well as a number of time-limited or one-time revenues. Beginning in 2018-19, the FAO is projecting more moderate revenue growth as:

- time-limited revenues end (including the debt retirement charge and federal equalization payments);
- economic growth moderates, following several years of stronger than average growth; and
- the fiscal impact of the Fair Hydro Plan increases, reducing electricity-sector revenues.

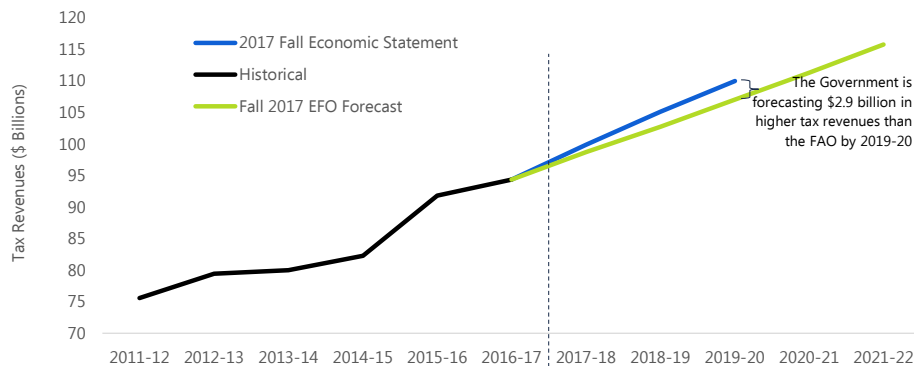
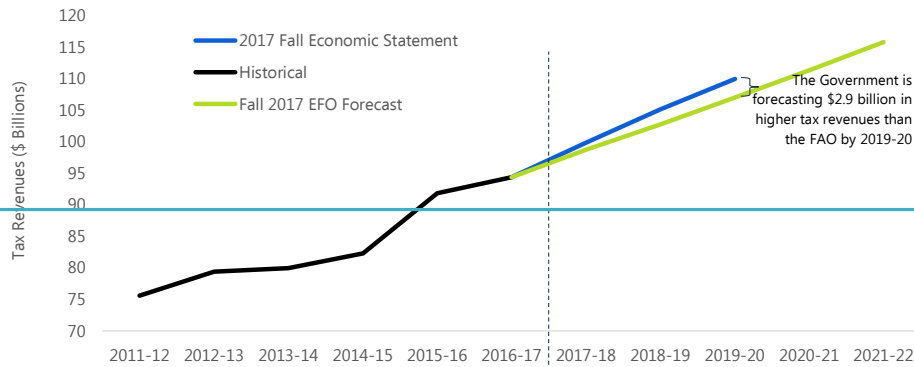
Tax Revenue Growth Expected to Moderate

Nominal GDP, the broadest measure of the tax base, is projected to grow by a strong 4.7 per cent in 2017, supporting a 4.6 per cent increase in tax revenues in 2017-18. From 2018 to 2021, annual GDP growth is expected to moderate to 4.1 per cent, leading to similar slowing in tax revenue growth to 4.1 per cent on average over this period.

In the government's Fall Economic Statement, tax revenue is projected to grow by 5.2 per cent on average from 2017-18 to 2019-20, much higher than the FAO's projection of 4.3 per cent over the same period. The government's expectation of higher growth results in an additional \$2.9 billion in tax revenues by 2019-20, relative to the FAO projection.

² 2016-17 Consolidated Financial Statements, Auditor General of Ontario, 2017

FAO's Taxation Revenue Outlook

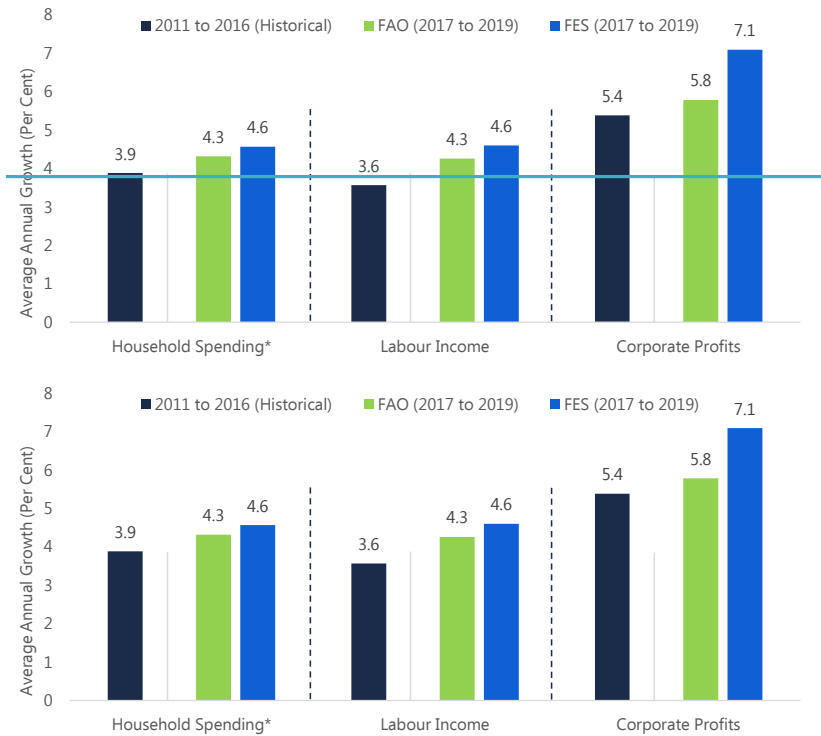


Source: Ontario Public Accounts, 2017 Ontario Economic Outlook and Fiscal Review and FAO.

The government's revenue forecast relies on more optimistic projections for many of the key economic drivers of tax revenue, including labour income; corporate profits; and household spending.

Growth in Key Tax Drivers

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* The FES forecast for Household Spending is Real Household Spending plus CPI.

Source: Statistics Canada, 2017 Ontario Economic Outlook and Fiscal Review and FAO.

While the FAO expects incomes and household spending to grow somewhat faster than recent historical trends,³ the government's tax revenue forecast is based on significant and sustained above-trend growth for each of the three key tax drivers.

The Loss of Time-limited Revenues

The Province's 2017-18 revenues incorporate a number of one-time or time-limited revenues that are set to expire. These include:

- a temporary increase to sales and rentals revenue, reflecting additional asset sales⁴;
- higher federal transfers for infrastructure;

³ Labour income is expected to grow above trend in part due to the increased minimum wage over the outlook (which is also expected to boost household spending). Estimates of Ontario corporate profits over the first half of 2017 imply very strong growth.

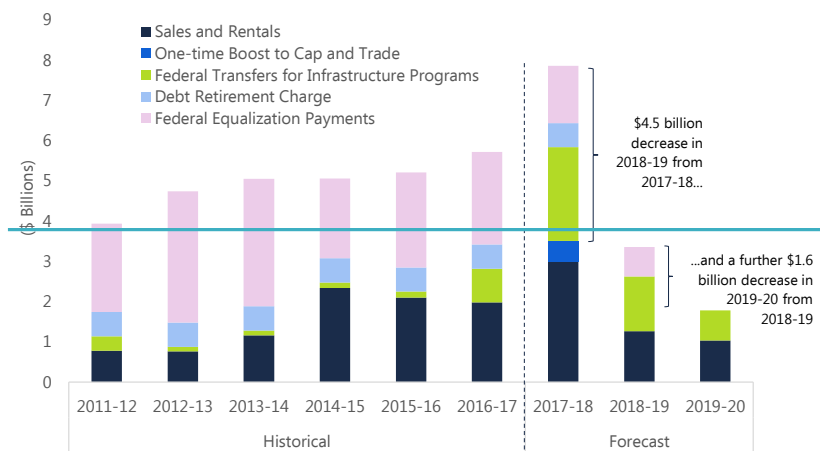
⁴ Asset sales include the Province's 22 per cent sale of Hydro One equity in 2017-18, which the FAO estimates would generate about \$0.8 billion in revenue.

CONFIDENTIAL DRAFT

- the final year of the debt retirement charge⁵;
- federal Equalization payments, which the FAO estimates will end in 2019-20; and
- revenue from an additional cap-and-trade auction that occurred in March 2017, which will be recognized in the 2017-18 fiscal year.⁶

Taken together, these time-limited revenues will decrease by \$4.5 billion in 2018-19, and by an additional \$1.6 billion in 2019-20.

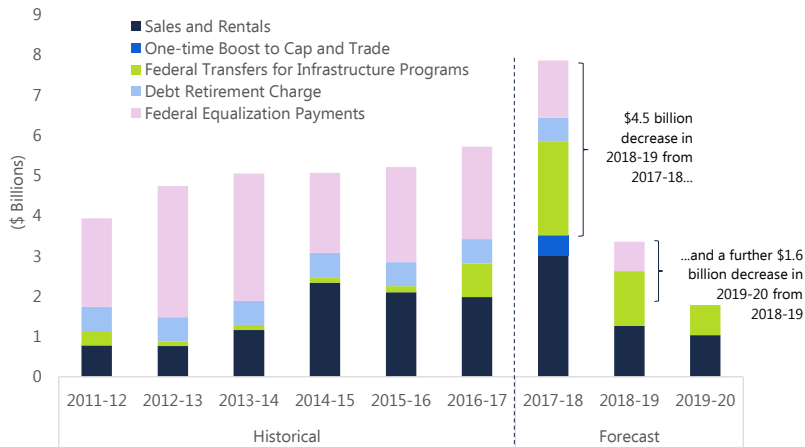
Many Time-limited Revenues are Set to Expire Beyond 2017-18



⁵ The debt retirement charge (DRC) is a charge payable on electricity consumed in Ontario and replaces a portion of debt servicing costs previously included as part of electricity bills before the restructuring of the former Ontario Hydro. The DRC will remain on electricity users' bills for electricity consumed before April 1, 2018.

⁶ In fiscal year 2017-18, there were five cap and trade auctions. Going forward the Provinces expects to have four auctions per year.

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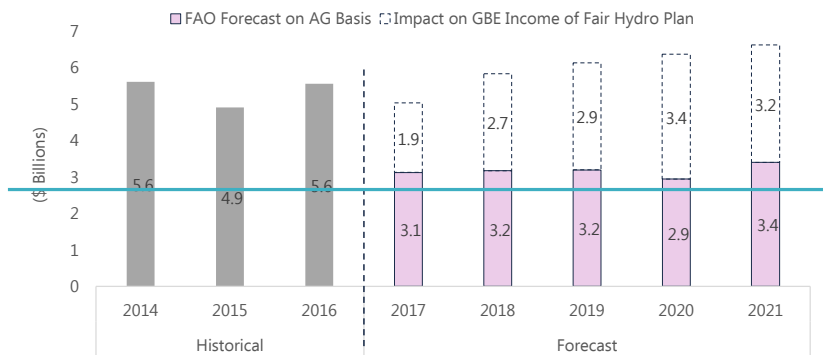


Source: Ontario Budgets, Ministry of Finance and FAO.

Government Business Enterprises and the Impact of the Fair Hydro Plan

The government introduced the "Fair Hydro Plan" to reduce electricity bills for residential customers by an average of 25 per cent. The government's plan includes subsidizing electricity prices for ratepayers through provincial and Ontario Power Generation (OPG) borrowing. Consistent with the AG's recommendation, the FAO captured the fiscal impact of this borrowing by reducing the net income of OPG by \$1.9 billion in 2017-18, and by \$3.2 billion by 2021-22.

Impact of the Fair Hydro Plan on Ontario's Revenue from 'Government Business Enterprises'



Source: Public Accounts, 2017 Ontario FES and FAO.

FAO Revenue Assumptions and Forecast

Revenue Source	Assumption	Forecast
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Taxation Revenue	Grows with key economic drivers including labour income, corporate profits and household spending	Averages 4.2 per cent growth per year from 2017-18 to 2021-22 ⁷
Federal Transfers	Based on legislated growth rates and economic forecasts for Ontario and Canada	Federal transfers are expected to grow by 1.6 per cent per year from 2017-18 to 2021-22
Government Business Enterprises (GBE)	Based on government projections, and adjusted for the impact of the Fair Hydro Plan as recommended by the Auditor General	Income from GBEs are projected to fall from \$5.6 billion in 2016-17 to \$3.1 billion in 2017-18 and remain roughly stable at that level to 2021-22
Other Revenue	Based on government projections, and includes asset sales, and proceeds from the sale of cap and trade allowances	These revenues are projected to increase from \$16.3 billion in 2016-17 to \$19.4 billion in 2017-18, before declining to \$18.0 billion by 2021-22

Expense Outlook

Program Spending

The FAO projects program spending to grow by 3.9 per cent from 2017-18 to 2021-22.⁸

⁷ The reduction in the Small Business Corporate Income Tax rate is reflected in the FAO's tax revenue projections.

⁸ Excluding the pension adjustment, the FAO projects program spending to grow by 3.5 per cent on average from 2017-18 to 2019-20, largely unchanged from the FAO's Spring EFO.

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Over the 2017-18 to 2019-20 period, the FAO's outlook adopts the government's 2017 Fall Economic Statement's projections for program spending, adjusted to reflect the Auditor General's recommended accounting presentation.⁹ The projection for program spending is largely unchanged from the 2017 Ontario Budget, aside from \$200 million of new spending in 2017-18, declining to \$100 million by 2019-20.¹⁰

Beyond 2019-20, the FAO projects program spending will grow at an annual average rate of 4.1 per cent. This stronger pace of growth reflects additional spending to meet two demographic pressures: the aging baby boomer cohort and the growing youth population. The growth in these two population groups will place added spending pressures on Ontario's health care and education systems.

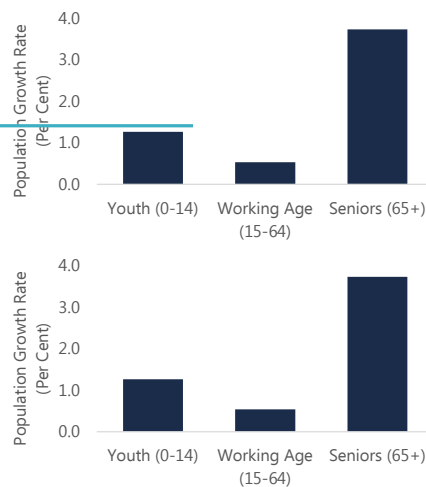
Interest on Debt

Interest on debt (IOD) payments are expected to increase at an average rate of 3.4 per cent per year over the outlook due to elevated borrowing levels and rising interest rates.

The decline in IOD as a share of revenues over the past three years was due to stronger revenue growth, lower borrowing and maturing debt being refinanced at much lower rates of interest.

However, this trend is expected to reverse over the outlook as revenue growth moderates while IOD payments accelerate. By 2021-22, Ontario's debt interest payments will account for 8.4 per cent of total revenue, slightly higher than the 8.1 per cent share in 2017-18.

Population Growth by Age (2016-2021)

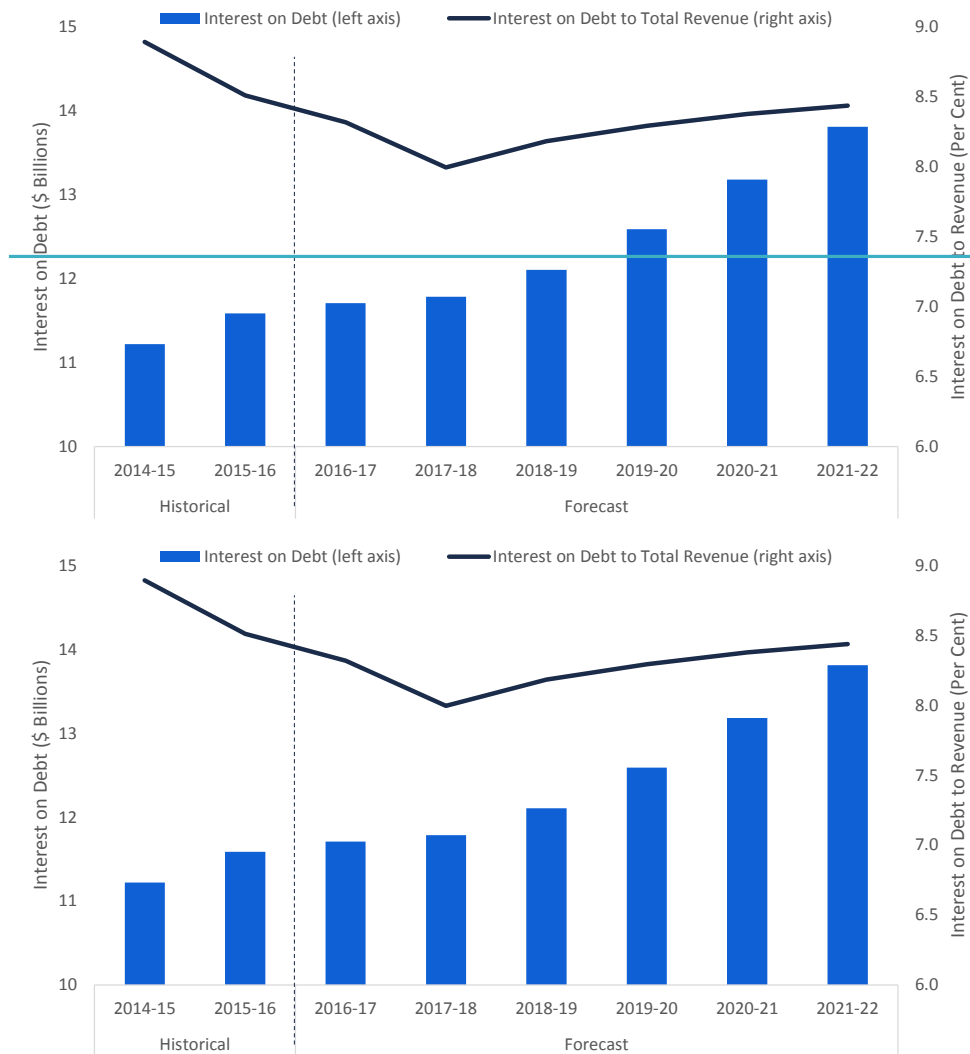


Source: Statistics Canada and FAO

Commented [AK2]: 2017 FES; it appears that the FAO does not use BPS-consolidated IOD; this choice also affects the IOD chart on page 6.

⁹ Based on information provided by the Ministry of Finance, the FAO's projection for 'Other Spending' includes \$2.3 billion in 2017-18 for the valuation allowance on jointly-sponsored pension assets, growing to \$2.9 billion by 2021-22.

¹⁰ In the 2017 FES, the government announced new funding for additional spending for small businesses, seniors and child care. However, the additional expenses for child care is fiscally neutral since it is funded by a corresponding increase in federal transfer revenue.

Interest on Debt

Source: Ontario Public Accounts and FAO.

Borrowing and Net Debt

Despite higher funding requirements for capital expenditures and the Fair Hydro Plan, Ontario's borrowing is expected to decline to \$23.25.8 billion in 2017-18, the lowest level of borrowing since 2007-8.

CONFIDENTIAL DRAFT

09. The relatively low level of borrowing in 2017-18 is largely the result of debt maturities falling by \$4.13.5 billion to \$17.4 billion.¹¹

Beginning 2018-19, borrowing requirements are expected to increase significantly due to higher annual debt maturities, additional funding requirements for the Fair Hydro Plan and rising capital expenditures. By 2021-22, the FAO expects borrowing to increase to \$42 billion – nearly double the borrowing requirement in 2017-18.

In 2017-18, the FAO projects that Ontario's net debt-to-GDP ratio will edge down, reflecting lower borrowing and strong economic growth. However, over the next five years, the FAO projects that nearly \$90 billion will be added to net debt – increasing the net debt-to-GDP ratio to 41 per cent by 2021-22.¹²

Commented [AK3]: 2016-17 maturities of 20.9 (from Q1 Finances) minus 2017-18 maturities of 17.4 (from FES FT)

Commented [JP4]: The Province has already factored in all borrowing requirements, including the debt burden projections for the Fair Hydro plan for that year, in consultation with OPG and retained consultants. The \$42 billion therefore is in excess of Ontario's projection by a significant amount.

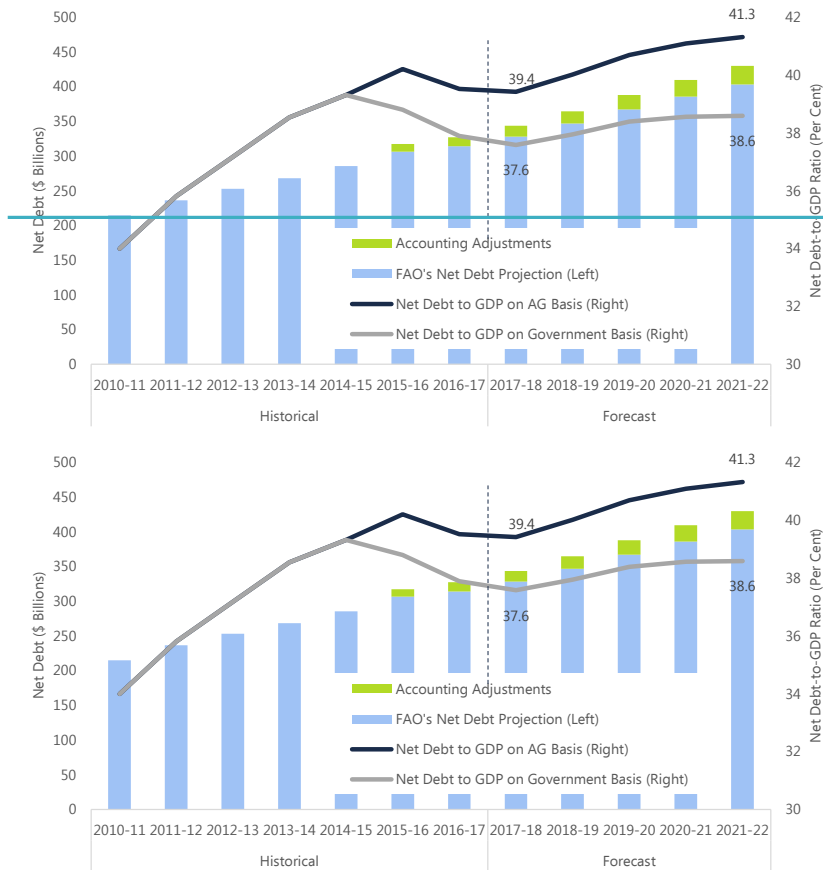
Commented [BL5]: The change in net debt reflects the change in the deficit and the change in Net Investment in Tangible Capital Assets – it should not be attributed to lower borrowing which is really the outcome

Commented [JP6]: With regard to the 41% by the FAO in 2021-22, the Province projects it to be 36.1% for that year as published in the Fall Economic Statement. In the Province's opinion, the FAO is likely factoring in a budget deficit that the government does not project for that year given the balanced budget commitment. The FAO's projections include the addition of the 2015-16 Pension adjustment despite the pronouncements of the Expert Panel that confirmed the correctness of the Government's accounting treatment of this asset. The FAO also includes additional Fair Hydro Plan debt that is not in line with provincial projections. The reversal of the pension adjustment is correct, and in line with the independent Pension Asset Expert Advisory Panel.

11 When debt matures the government must roll over the maturing debt with new borrowing. Declines in maturities result in lower borrowing and vice versa.

12 The FAO's estimate of net debt incorporates the AG's recommended accounting framework.

Net Debt Outlook



Source: FAO and 2017 Ontario Economic Outlook and Fiscal Review, Ontario Public Accounts

The government continues to maintain a net debt-to-GDP target of 35 per cent by 2023-24 and 27 per cent by 2029-30. However, the FAO's net debt-to-GDP projections under both accounting presentations suggest that additional fiscal measures would be required for the government to achieve its net debt-to-GDP targets.

From: [Gadi Mayman](#)
To: [Ken Kandeepan](#)
Cc: [Christina Zhang](#)
Subject: Fw: PA
Date: Tuesday, September 27, 2016 7:20:18 AM

Thoughts?

Original Message

From: Gadi Mayman <Gadi.Mayman@ofina.on.ca>
Sent: Tuesday, September 27, 2016 7:19 AM
To: Scott Thompson (CAB); Ghiassi, Ali (MOF)
Cc: Greg Orenszak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF)
Subject: Re: PA

I agree on the deficit, I'm still a little unsure on the treatment of net debt. Do we back out the full 10.6, just the 9.1 opening adjustment and not the 1.5 that goes into the 15-16 deficit, or do we leave the full 10.6 in? I suppose it would depend on what the reg says about whether the 15-16 PA amounts are permanent, or that they would be reversed going forward if the process determines that this interpretation is incorrect, and we then proceed with the 16-17 and 17-18 numbers as if they will be backed out.

Original Message

From: Thompson, Scott (MOF)
Sent: Tuesday, September 27, 2016 6:50 AM
To: Ghiassi, Ali (MOF)
Cc: Greg Orenszak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF); Gadi Mayman
Subject: Re: PA

Am looping in Gadi and Tim to this discussion in case they have an alternate view. My understanding has been that if we are clear in the regulation that this treatment is for the fy 15-16 only and that there is a process underway to develop the treatment for future years, then we can continue the course we were already on for FES and Budget for 16-17 year and beyond. It may be difficult to explain, but I think we have a solid argument on deficit numbers. Net debt may be more difficult to explain because we will have already added the 10.6 bn in for 15-16 and we'll have to back it out of net debt for FES.

Thanks
Scott

Sent from my iPad

> On Sep 27, 2016, at 12:02 AM, Ghiassi, Ali (MOF) <Ali.Ghiassi@ontario.ca> wrote:
>
> Scott, Greg,
>
> A point of clarification prior to tomorrow morning's meeting with Premier. Should the government agree to regulated accounting pursuant to the AG's interpretation for a one year period (ie 15-16) resulting in a \$5B deficit for the last fiscal year, what is its reporting obligations in the FES for 16-17 through to 18-19?
>
> Ali Ghiassi
> Chief of Staff
> Minister of Finance
> 416.948.5409
>

From: [Gadi Mayman](#)
To: [Ken Kandeepan](#)
Cc: [Christina Zhang](#)
Subject: Fw: PA
Date: Tuesday, September 27, 2016 7:52:46 AM

Original Message

From: Schuurman, Tim (MOF) <Tim.Schuurman@ontario.ca>
Sent: Tuesday, September 27, 2016 7:44 AM
To: Scott Thompson (CAB); Gadi Mayman; Ghiassi, Ali (MOF)
Cc: Greg Orencsak (MOF); Mike Jancik (OPO)
Subject: Re: PA

Hey everyone - I don't have anything to add, other than to affirm what Scott said, that as long as the regulation is clear it's only for one year and there's a review underway to determine the impact on future years, we can stick with the budget plan accounting framework for now.

The rest is issues management (including I think Gadi's issue on net debt) which would need to be dealt with through a series of footnotes (as detailed expense information, including for years prior to 16-17 is also published explicitly in FES, including pension expense for tpp and pssp) as well as narrative , comms products and Q's and A's.

Tim

Original Message

From: Thompson, Scott (MOF)
Sent: Tuesday, September 27, 2016 7:32 AM
To: Mayman, Gadi (OFA); Ghiassi, Ali (MOF)
Cc: Orencsak, Greg (TBS); Jancik, Mike (TBS); Schuurman, Tim (MOF)
Subject: RE: PA

I think the reg and/or the comms materials would have to make clear that the 15-16 PA amounts are not permanent, that they are subject to adjustment following the review that will be launched. The 'legislated' version of the PA (Chart 10) increases the debt every year from 2011-12 to 15-16, with the increased amounts falling into the 'other types of liabilities' section. By 2015-16 the difference in the Debt between non-legislated and legislated options is the \$10.6 bn that we've been discussing

-----Original Message-----

From: Gadi Mayman [<mailto:Gadi.Mayman@ofina.on.ca>]
Sent: September-27-16 7:19 AM
To: Thompson, Scott (MOF); Ghiassi, Ali (MOF)
Cc: Orencsak, Greg (TBS); Jancik, Mike (TBS); Schuurman, Tim (MOF)
Subject: Re: PA

I agree on the deficit, I'm still a little unsure on the treatment of net debt. Do we back out the full 10.6, just the 9.1 opening adjustment and not the 1.5 that goes into the 15-16 deficit, or do we leave the full 10.6 in? I suppose it would depend on what the reg says about whether the 15-16 PA amounts are permanent, or that they would be reversed going forward if the process determines that this interpretation is incorrect, and we then proceed with the 16-17 and 17-18 numbers as if they will be backed out.

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From: Thompson, Scott (MOF)

Sent: Tuesday, September 27, 2016 6:50 AM

To: Ghiassi, Ali (MOF)

Cc: Greg Orencsak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF); Gadi Mayman

Subject: Re: PA

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Thanks

Scott

Sent from my iPad

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>

> Ali Ghiassi

> Chief of Staff

> Minister of Finance

> 416.948.5409

>

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From: [Gadi Mayman](#)
To: [Ken Kandeepan](#)
Cc: [Christina Zhang](#)
Subject: Fwd: PA
Date: Tuesday, September 27, 2016 7:43:09 AM

Begin forwarded message:

From: Gadi Mayman <Gadi.Mayman@ofina.on.ca>
Date: September 27, 2016 at 7:42:02 AM EDT
To: "Greg Orencsak (MOF)" <Greg.Orencsak@ontario.ca>
Cc: "Scott Thompson (CAB)" <Scott.Thompson@ontario.ca>, "Ghiassi, Ali (MOF)" <Ali.Ghiassi@ontario.ca>, "Mike Jancik (OPO)" <Mike.Jancik@ontario.ca>, "Tim Schuurman (MOF)" <Tim.Schuurman@ontario.ca>
Subject: Re: PA

I guess we'd have to make an assumption in the FES on net debt, and explain what assumption we are making. If we assume it all gets reversed, we'll show just a 1.4 or 1.5% spike in net debt to GDP for 15-16, with it dropping back in 16-17. If we assume that while we'd go back to the accounting treatment we've used for the past 15 years going forward, but leave the PA reported opening adjustment and 15-16 deficit untouched going forward, the 1.4 or 1.5% increase would permanently increase the level of net debt to GDP going forward, although we'd, depending on deficit and capital spending amounts going forward, still be able to show it levelling off and starting to drop, albeit from a higher level.

I hate to say this, but we might need to show both lines, because if we don't, someone else will do it for us. The reason I hate the idea is twofold: the concept of two sets of books, and also because then it will encourage people to ask questions about a third line: what would net debt and the deficit look like if the process we are undertaking determines that the regulated treatment is correct?

In any case, we'd have to make it clear that none of these adjustments affect the Province's borrowing program, as they are not cash adjustments.

On Sep 27, 2016, at 7:24 AM, Orencsak, Greg (TBS) <Greg.Orencsak@ontario.ca> wrote:

Gadi, the regulation would only prescribe 15-16, so that's the only year it speaks to. No reference in reg to process, as that's not a regulatory matter.

Greg

On Sep 27, 2016, at 7:19 AM, Gadi Mayman
<Gadi.Mayman@ofina.on.ca> wrote:

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Original Message

From: Thompson, Scott (MOF)

Sent: Tuesday, September 27, 2016 6:50 AM

To: Ghiassi, Ali (MOF)

Cc: Greg Orencsak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF); Gadi Mayman

Subject: Re: PA

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Ali Ghiassi

Chief of Staff

Minister of Finance

416.948.5409

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From: [Gadi Mayman](#)
To: [Ken Kandeepan](#)
Cc: [Christina Zhang](#)
Subject: Fwd: PA
Date: Tuesday, September 27, 2016 7:43:21 AM

Begin forwarded message:

From: "Thompson, Scott (MOF)" <Scott.Thompson@ontario.ca>
Date: September 27, 2016 at 7:32:17 AM EDT
To: "Mayman, Gadi (OFA)" <Gadi.Mayman@ofina.on.ca>, "Ghiassi, Ali (MOF)" <Ali.Ghiassi@ontario.ca>
Cc: "Orencsak, Greg (TBS)" <Greg.Orencsak@ontario.ca>, "Jancik, Mike (TBS)" <Mike.Jancik@ontario.ca>, "Schuurman, Tim (MOF)" <Tim.Schuurman@ontario.ca>
Subject: RE: PA

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Sent: September-27-16 7:19 AM
To: Thompson, Scott (MOF); Ghiassi, Ali (MOF)
Cc: Orencsak, Greg (TBS); Jancik, Mike (TBS); Schuurman, Tim (MOF)
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To: Ghiassi, Ali (MOF)
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Ali Ghiassi

Chief of Staff

Minister of Finance

416.948.5409

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message, including any attachments, without reading them, and destroy all copies.
Thank you.

From: [Anna Strathy](#)
To: [Ronald Kwan](#)
Subject: RE: Auditor General Report on Fair Hydro Plan
Date: Tuesday, October 17, 2017 10:52:11 AM
Attachments: [Clean - OFHP - Media Briefing_Oct16_Tracked_630_2_DMO edits.pptx](#)
[QA_AG Report OFHP_Technical Briefing_Oct16_Clean_200.docx](#)

Hi Ron, please see attached.

From: Ronald Kwan
Sent: Tuesday, October 17, 2017 10:49 AM
To: Anna Strathy <Anna.Strathy@ofina.on.ca>
Subject: Re: Auditor General Report on Fair Hydro Plan

Hi Anna,

Did we get the final slide deck and sets of Qs&As?

Ron

On Oct 17, 2017, at 10:43 AM, Anna Strathy <Anna.Strathy@ofina.on.ca> wrote:

FYI, AG's News Release attached. The report is now public.

Full report: <http://www.auditor.on.ca/en/content/specialreports/srlast5years.html>

From: Pichette, Marc (MOF) [<mailto:Marc.Pichette@ontario.ca>]
Sent: Tuesday, October 17, 2017 10:41 AM
To: Giroux Namian, Orli (MOF) <Orli.GirouxNamian@ontario.ca>; Koukoulas, Sophia (MOF) <Sophia.Koukoulas@ontario.ca>; Martin, Jessica (MOF) <Jessica.Martin@ontario.ca>; Moore, Brynne (MOF) <Brynne.Moore@ontario.ca>
Cc: Usman Zahid <Usman.Zahid@ofina.on.ca>; Birks, Ryan (MOF) <Ryan.Birks@ontario.ca>; Anna Strathy <Anna.Strathy@ofina.on.ca>; Ghufuran Tarin (MOF) <Ghufuran.Tarin@ontario.ca>; Kim, Minzi (MOF) <Minzi.Kim@ontario.ca>; Martha Maloney (MOL) <Martha.Maloney@ontario.ca>; Matthew Sylvain (MOF) <Matthew.Sylvain@ontario.ca>; Dianne Lone (MOF) <Dianne.Lone@ontario.ca>; @FIN-L-O-CSB-ISSUES <FIN-L-O-CSB-ISSUES@msgov.gov.on.ca>
Subject: Auditor General Report on Fair Hydro Plan

News Release

For Immediate Release October 17, 2017
Auditor General Says Provincial Government Plans to Obscure the Financial Impact of Electricity Rate Cuts

(TORONTO) In a Special Report, the Auditor General says the government created an unnecessary, complex financing structure to keep the true financial impact of most of its 25% electricity-rate reduction off the Province's books—a decision that could cost Ontarians up to \$4 billion more than necessary in interest costs over the next 30 years.

The Province is proposing to use accounting that does not follow its own policy for preparing financial statements under independently set Canadian Public Sector Accounting Standards. This hides the real financial impact of the government's electricity rate reduction from Ontarians by understating future annual deficits and net debt.

"The accounting proposed by the government is wrong and if used would make the Province's budgets and future consolidated financial statements unreliable," said Bonnie Lysyk after the report was tabled. "This cannot be taken lightly.

"We're not questioning the government's policy decision to give Ontarians a discount on their electricity rates. What we are questioning is how the government is going to report the effects of that decision to the people of Ontario. There's still time to fix it, and we're encouraging the government to do so."

In reaching its conclusions, the Office of the Auditor General obtained extensive advice from Canada's current

Auditors General, a former Auditor General of Saskatchewan and British Columbia, and external advisers, including the recently retired Director of the Canadian Public Sector Accounting Board.

The Special Report, titled The Fair Hydro Plan: Concerns about Fiscal Transparency, Accountability and Value for Money, examines in detail the "needlessly complex" financing structure the Ontario government created to achieve the accounting result it desired.

According to the Financial Accountability Office of Ontario, the total cost of the Fair Hydro Plan's electricity rate reduction is estimated to be \$39.4 billion over 30 years, including about \$4 billion in extra interest charges. These charges are "extra" because the Province does not plan to borrow all the money directly.

Instead, the financial structure the government designed has other government entities, including Ontario Power Generation, borrowing at higher interest rates.

“Internal records show that senior government officials were aware their approach to borrowing could result in Ontarians paying significantly more than necessary,” Lysyk said. The Special Report recommends the government report the true financial impact of its electricity rate reduction plan in the Province’s budgets and consolidated financial statements, and use the least costly financing structure to fund the electricity-rate reduction.

-30-

For more information, please contact:

Bonnie Lysyk

Auditor General

(416) 327-1326 Visit www.auditor.on.ca to read the Report.

The Office of the Auditor General is an independent office of the Legislative Assembly serving all Members of the Assemb

<newsrelease_2017fairhydro.pdf>

Ontario's Fair Hydro Plan – Status Update

Technical Briefing

October 17, 2017

Ontario's Electricity System

- Ontario's electricity system is a \$20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries – with costs transparently recovered.
- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It approves rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.
- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it. It also manages contracts with non-regulated generators. In addition, the IESO plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.
- Ontario Power Generation (OPG) is wholly-owned by the Province of Ontario and produces almost half of the electricity used in Ontario. OPG owns and operates: two nuclear stations, 66 hydroelectric stations, two biomass stations and one thermal station.

Ontario's Fair Hydro Plan

- Ontario's Fair Hydro Plan (OFHP) is delivering rate relief to residential consumers, farms, most small businesses, long-term care homes and condominiums. This includes the 8% rebate equivalent to the provincial portion of the HST that came into effect on January 1, 2017.
- OFHP is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.
- The government, OPG, IESO, OEB, key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.
- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
 - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
 - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
 - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
 - July 1, 2017: The full 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.
- The new and enhanced existing electricity social programs include:
 - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
 - Expanded Ontario Electricity Support Program;
 - New First Nations On-Reserve Delivery Credit; and
 - New Affordability Fund.
- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province (\$M)	16-17	17-18	18-19	19-20	20-21	5-Year Total
RRRP Enhancements	-	459	472	484	497	1,912
Ontario Electricity Support Program	-	186	261	325	375	1,147
On-Reserve First Nation Delivery Credit	-	20	20	20	20	80
Affordability Fund	200	-	-	-	-	200
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	300	883	860	861	871	3,775
Total Fiscal Cost to the Province	500	1,548	1,613	1,690	1,763	7,114

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- 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 are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.
- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, 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.
- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.
- The GA refinancing program ensures that costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.
- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (e.g. Navigant, KPMG, EY and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March 2017 announcement of Ontario's Fair Hydro Plan (OFHP), the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
 - Current government estimates forecast the peak debt over the thirty year life of OFHP will be below \$20 billion. The preliminary estimate from March 2017 was about \$28 billion.
- The revised debt estimates are the result of the following factors:
 - The IESO updated its long-term cost projections for the electricity system and residential bills;
 - The OEB provided “actual data” with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
 - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).
- It should be noted that 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 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.

GA Refinancing – Role of Ontario Power Generation (OPG)

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
 - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
 - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.
- OPG currently manages approximately \$20 billion nuclear funds and as an entity regulated by the OEB, OPG also has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
 - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

GA Refinancing – Role of the Independent Electricity System Operator (IESO)

- The IESO administers \$17 billion of the \$20 billion annual electricity system, settling transactions between generators and consumers of electricity.
 - Market accounts and liabilities are included on IESO financial statements to provide increased transparency around the value of transactions that flow through the market.
 - The IESO is a corporation established pursuant to Part II of the Electricity Act, 1998, and prepares its financial statements in accordance with Public Sector Accounting Standards (PSAS).
- Under Ontario's Fair Hydro Plan (OFHP), IESO continues to invoice eligible customers – but not collect – the full amount of Global Adjustment (GA) every month.
- The IESO's right to recover these costs from future ratepayers, constitutes a regulatory asset. The regulatory asset, is transferred to the Fair Hydro Plan Trust.
- The IESO will reflect the impact of the GA refinancing using rate-regulated accounting:
 - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
 - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
 - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.
- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (Electricity Act) and the Ontario Energy Board Act (OEBA).

GA Refinancing – Accounting Considerations

- 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.
- PSAS is 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 in this scenario.
- Section PS 1150.07 from the Public Sector Accounting Handbook:
 - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.*
- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.
- OFHP 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.

Questions?

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 Auditor 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.

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 billion¹⁵ to \$18.5 billion¹⁶. 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 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.

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

¹⁹ Ontario Financing Authority

²⁰ Ontario Power Generation

²¹ Ontario Power Generation

debt over the thirty year life of OFHP will be below \$20 billion²². The preliminary estimate from March 2017 was about \$28 billion²³.

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.”

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 billion²⁴ to \$18.5 billion²⁵. 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 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.

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 billion²⁹. The preliminary estimate from March 2017 was about \$28 billion³⁰.

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:

²² Ministry of Energy

²³ Ministry of Energy, submission to Financial Accountability Officer

²⁴ Ministry of Energy

²⁵ Ministry of Energy

²⁶ Ministry of Energy

²⁷ Ministry of Energy

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

Peak debt for OFHP has been revised down substantially from March 2017, from about \$27.7 billion³¹ to \$18.5 billion³². The higher March 2017 estimate was used by the FAO in its May 2017 report.

If pressed on interest costs:

The Ministry estimates of total interest cost also decreased from \$25 billion³³ to \$18 billion³⁴.

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.

³¹ Ministry of Energy

³² Ministry of Energy

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*

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.

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.

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

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.

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.

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.

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.

⁴⁰ Ministry of Energy

⁴¹ Ministry of Energy, submission to Financial Accountability Officer

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 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?

⁴² Ministry of Energy

⁴³ Ministry of Energy, submission to Financial Accountability Officer

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.

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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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 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

From: [Bonnie Lemcke](#)
To: [Anna Strathy](#)
Subject: RE: Final OFHP AG Products
Date: Tuesday, October 17, 2017 12:16:41 PM

This info is public correct?

Bonnie

From: Anna Strathy
Sent: Tuesday, October 17, 2017 12:15 PM
To: Bonnie Lemcke <Bonnie.Lemcke@ofina.on.ca>
Subject: FW: Final OFHP AG Products

FYI sounds like no press release.

From: Lone, Dianne (MOF) [<mailto:Dianne.Lone@ontario.ca>]
Sent: Tuesday, October 17, 2017 11:29 AM
To: Anna Strathy <Anna.Strathy@ofina.on.ca>
Subject: FW: Final OFHP AG Products

Here are finals from Energy.

From: Barbaro, Rachel (ENERGY)
Sent: October 17, 2017 11:18 AM
To: Lone, Dianne (MOF)
Cc: Evans, Karen (ENERGY)
Subject: Final OFHP AG Products

Hi Dianne, finals attached. Pls note, nothing is going on newsroom or going out to media. MO will use fact sheet reactively.

Thanks
Rachel

Rachel Barbaro

Manager, Strategic Communications
Ministry of Energy, Communications Branch
416 212 4634

From: [Anna Strathy](#)
To: [Bonnie Lemcke](#)
Subject: RE: Final OFHP AG Products
Date: Tuesday, October 17, 2017 12:16:57 PM

Hm, not sure. Let me check.

From: Bonnie Lemcke
Sent: Tuesday, October 17, 2017 12:17 PM
To: Anna Strathy <Anna.Strathy@ofina.on.ca>
Subject: RE: Final OFHP AG Products

This info is public correct?

Bonnie

From: Anna Strathy
Sent: Tuesday, October 17, 2017 12:15 PM
To: Bonnie Lemcke <Bonnie.Lemcke@ofina.on.ca>
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Thanks
Rachel

Rachel Barbaro
Manager, Strategic Communications
Ministry of Energy, Communications Branch

416 212 4634

From: [Ken Kandeepan](#)
To: [Gadi Mayman](#)
Cc: [Christina Zhang](#)
Subject: RE: PA
Date: Tuesday, September 27, 2016 8:50:45 AM

Good point re the IFRS, I guess reading between the lines in the email chain the Government is accepting the AG's position and the reference to legislation is to allow the accumulated deficit at the end of 15-16 to be revised upwards by 10.6 given that OPCD and Deloitte indicate that this revision is not in accordance with PSAB.

Thanks

Ken K

From: Gadi Mayman
Sent: Tuesday, September 27, 2016 7:56 AM
To: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>
Cc: Christina Zhang <Christina.Zhang@ofina.on.ca>
Subject: Re: PA

Not to mention the IFRS issue next year. I think the indication we're getting from Scott's email is to go with my second option and reverse the whole thing out for our FES calculations for 16-17 onwards.

From: Ken Kandeepan
Sent: Tuesday, September 27, 2016 7:48 AM
To: Gadi Mayman
Cc: Christina Zhang
Subject: Re: PA

If the PA net debt includes the 10.6 it's going to be very difficult to back that out in the FES. You can't have the FES on a different starting basis from the published accounts of the Province.

There is some flexibility however going forward in the sense that we can exclude this adjustment for the annual deficit forecast for 16-17 onwards on the basis that the issue is still being reviewed.

Having said that I see no indication that the AG will be willing to reverse her position for the 16-17 PA. At which time the issue will be whether to accept her position for good or take the qualification.

Thanks

Ken k

On Sep 27, 2016, at 7:20 AM, Gadi Mayman <Gadi.Mayman@ofina.on.ca> wrote:

Thoughts?

Original Message

From: Gadi Mayman <Gadi.Mayman@ofina.on.ca>

Sent: Tuesday, September 27, 2016 7:19 AM

To: Scott Thompson (CAB); Ghiassi, Ali (MOF)

Cc: Greg Orencsak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF)

Subject: Re: PA

I agree on the deficit, I'm still a little unsure on the treatment of net debt. Do we back out the full 10.6, just the 9.1 opening adjustment and not the 1.5 that goes into the 15-16 deficit, or do we leave the full 10.6 in? I suppose it would depend on what the reg says about whether the 15-16 PA amounts are permanent, or that they would be reversed going forward if the process determines that this interpretation is incorrect, and we then proceed with the 16-17 and 17-18 numbers as if they will be backed out.

Original Message

From: Thompson, Scott (MOF)

Sent: Tuesday, September 27, 2016 6:50 AM

To: Ghiassi, Ali (MOF)

Cc: Greg Orencsak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF); Gadi Mayman

Subject: Re: PA

Am looping in Gadi and Tim to this discussion in case they have an alternate view. My understanding has been that if we are clear in the regulation that this treatment is for the fy 15-16 only and that there is a process underway to develop the treatment for future years, then we can continue the course we were already on for FES and Budget for 16-17 year and beyond. It may be difficult to explain, but I think we have a solid argument on deficit numbers. Net debt may be more difficult to explain because we will have already added the 10.6 bn in for 15-16 and we'll have to back it out of net debt for FES.

Thanks

Scott

Sent from my iPad

On Sep 27, 2016, at 12:02 AM, Ghiassi, Ali (MOF)

<Ali.Ghiassi@ontario.ca> wrote:

Scott, Greg,

A point of clarification prior to tomorrow morning's meeting with Premier. Should the government agree to regulated accounting pursuant to the AG's interpretation for a one year period (ie 15-16)

resulting in a \$5B deficit for the last fiscal year, what is its reporting obligations in the FES for 16-17 through to 18-19?

Ali Ghiassi

Chief of Staff

Minister of Finance

416.948.5409

From: [Ken Kandeepan](#)
To: [Gadi Mayman](#)
Cc: [Christina Zhang](#)
Subject: RE: PA
Date: Tuesday, September 27, 2016 9:05:43 AM

Thanks very interesting, on one hand legislation needs to be passed to avoid qualification, on the other hand the previous passage of legislation allowing OPG and H1 to adopt US GAAP may result in a qualification next year.

Ken K

From: Gadi Mayman
Sent: Tuesday, September 27, 2016 9:03 AM
To: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>
Cc: Christina Zhang <Christina.Zhang@ofina.on.ca>
Subject: Re: PA

Two choices are going to be presented at the meeting they're having today.

From: Ken Kandeepan
Sent: Tuesday, September 27, 2016 8:50 AM
To: Gadi Mayman
Cc: Christina Zhang
Subject: RE: PA

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Thoughts?

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To: Scott Thompson (CAB); Ghiassi, Ali (MOF)
Cc: Greg Orenszak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF)
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Ali Ghiassi

Chief of Staff

Minister of Finance

416.948.5409

From: [Ken Kandeepan](#)
To: [Gadi Mayman](#)
Cc: [Christina Zhang](#)
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Date: Tuesday, September 27, 2016 10:00:24 AM

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416.948.5409

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Date: Tuesday, September 27, 2016 10:08:47 AM

So many moving parts at the moment that it's best to sit and wait for the outcome. Right now the idea is, if going with the legislated option, that deficits would be adjusted going back and the net debt to GDP and to revenue ratios would be adjusted back for each year. They've included those numbers in the presentation that they're showing now.

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Cc: Greg Orenacsak (MOF); Mike Jancik (OPO); Tim Schuurman (MOF); Gadi Mayman
Subject: Re: PA

Am looping in Gadi and Tim to this discussion in case they have an alternate view. My understanding has been that if we are clear in the regulation that this treatment is for the fy 15-16 only and that there is a process underway to develop the treatment for future years, then we can continue the course we were already on for FES and Budget for 16-17 year and beyond. It may be difficult to explain, but I think we have a solid argument on deficit numbers. Net debt may be more difficult to

explain because we will have already added the 10.6 bn in for 15-16 and we'll have to back it out of net debt for FES.

Thanks

Scott

Sent from my iPad

On Sep 27, 2016, at 12:02 AM, Ghiassi, Ali (MOF) <Ali.Ghiassi@ontario.ca> wrote:

Scott, Greg,

A point of clarification prior to tomorrow morning's meeting with Premier. Should the government agree to regulated accounting pursuant to the AG's interpretation for a one year period (ie 15-16) resulting in a \$5B deficit for the last fiscal year, what is its reporting obligations in the FES for 16-17 through to 18-19?

Ali Ghiassi

Chief of Staff

Minister of Finance

416.948.5409