

CONTRASTING RESPONSES TO AUDITORS GENERAL OPINIONS ON USE OF DEFERRAL ACCOUNTING IN ONTARIO AND BRITISH COLUMBIA

The recent discussion at the Ontario and BC public accounts committees about the respective provincial auditor general's criticism of the use of deferral (or regulatory) accounting is revealing. The senior ranks of the Ontario public service turned out in force to respond to Ontario Auditor General Bonnie Lysyk's severe criticism of the practice, while the response in BC was much more muted.

REGULATED (DEFERRAL) ACCOUNTING AND ONTARIO'S "FAIR HYDRO" PLAN

The rapid increase in the price of electricity, and the outlook for even higher future rates, resulted in a significant erosion of public support for the government. In response, the Liberal government legislated the "Fair Hydro" plan in early 2017, which reduced the prices by 25%, and subsidized the increases for the next 10 years by increased borrowings.¹

Beginning in 2028, electricity ratepayers will pay a surcharge to recoup the principal and interest of the borrowed funds. The legislation created a special regulatory deferral account to record the future revenue surcharge as an asset, allowing it to avoid reporting the borrowed money as a deficit and debt on the government's financial statements.

Auditor General Lysyk objected to the accounting slight-of-hand as the government's legislated deferral account was treating the hypothetical future surcharge revenue as an asset, and that the approval of a deferral under the rules of the regulatory accounting standard requires an independent regulator.²

On 6 December 2017 Auditor General Lysyk said the government's continued use of non-standard accounting, including the adoption of legislated regulatory accounting, will seriously distort the true state of the province's finances.³

¹ http://theyyee.ca/Opinion/2017/10/24/Will-NDPEnd-BC-Hydro-Wild-West-Accounting/?utm_source=daily&utm_medium=email&utm_campaign=241017

²

http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_44_26_october_2017/pdf/occasional_paper_no_44_26_october_2017.pdf and <https://cpi.probeinternational.org/2017/10/18/auditor-general-rips-into-the-fair-hydro-plan/>

³ http://www.auditor.on.ca/en/content/news/17_newsreleases/2017news_v1_overall.pdf

The Public Accounts Committee (PAC) Hearing

On 28 February 2018 the PAC met to review the 2016/17 public accounts, including the accounting changes required to give effect to the legislated deferral account at the Independent Electrical System Operator (IESO) agency.

The government, already suffering from the negative publicity produced by the objections of both the Auditor General and the independent Financial Accountability Office,⁴ had a surprising number of the top public servants attend to explain the changes and answer the expected questions from the MLAs (the general election was only months away).

The senior government staff included the secretary of Treasury Board, the controller general, the deputy minister of finance, the deputy energy minister and even the secretary of cabinet (the top public servant in the government). At the committee's request the top officials of the IESO, the Ontario Power Authority and the Ontario Financing Authority were also in attendance.

Clearly the government was anxious about containing potential further criticism of its reliance on deferral accounting to achieve a balanced budget.

Auditor Roles

Kim Marshall, the chief financial officer of IESO defended its use of regulatory (deferral) accounting by saying the presentation of the financial statements was approved by IESO's external auditor.⁵

Ms. Kim Marshall: We believe our financial statements are presented in a way that is understood by everyone. They are in line with the guidance we have received from our external auditor, KPMG, and they are in line with most of the other entities like us in North America.

Mr. John Vanthof: Is KPMG the Auditor General of Ontario?

Ms. Kim Marshall: No, obviously not.

Mr. John Vanthof: Are you a public entity?

Ms. Kim Marshall: We are a public entity.

4

http://www.bcpolicy Perspectives.com/media/attachments/view/doc/occasional_paper_no_31_26_may_2017/pdf/occasional_paper_no_31_26_may_2017.pdf

⁵ http://www.ontla.on.ca/web/committee-proceedings/committee_transcripts_details.do?locale=en&Date=2018-02-28&ParlCommID=9001&DocumentID=34653

Mr. John Vanthof: So would it not make sense for a public entity to be audited in a way that is agreed upon by the Auditor General of Ontario? Quite frankly, KPMG is not an independent officer of the Legislature; the Auditor General is.

Political Direction for Deferral Account?

Later, opposition member Randy Hillier questioned deputy energy minister Sergio Imbrogno as to who directed the adoption of rate regulated accounting:

Mr. Randy Hillier: Okay. Were you directed to keep the hydro rate relief policy—were you directed that that policy could not add to the bottom line, to the debt of this province? Were you directed or asked or encouraged to hide, or develop a process to hide, the additional cost from appearing on the public books?

Mr. Serge Imbrogno: Mr. Hillier, I tried to answer that with a bit more of the policy context. I think we've tried to explain that on the electricity—

Mr. Randy Hillier: Were you told by anybody that your policy of hydro relief could not add to the public debt or deficit?

Mr. Serge Imbrogno: What I'm saying is that we work within that policy construct of the ratepayer today would pay less, the ratepayer—

Mr. Randy Hillier: You can say no or you can say yes.

Mr. Serge Imbrogno: I just want to make sure you understand what—we had a cabinet direction. "Here's the policy. Here is the intent"—

Mr. Randy Hillier: Part of that direction—was it to not permit any additional debt or deficit to show up on the provincial books?

Mr. Serge Imbrogno: No, the policy direction was that we would keep those costs within the rate base. Once you decided to keep those costs in the rate base, then the accountants would decide after the fact how you account for it. The policy intent is what makes sense for the taxpayer to pay and what makes sense for the ratepayer to pay. Then the accounting would follow that.

Mr. Randy Hillier: So at no time did any other ministry say to you, "Whatever you do with this fair hydro plan, it can't show a greater debt on the public books"? At no time did anybody say that to you?

Mr. Serge Imbrogno: No, I think what I'm trying to say is that it was always understood that this was a ratepayer cost that would be borne by the ratepayer, and the accounting would follow that.

The PAC discussion never focused on the issue of whether the use of regulated accounting meets the fundamental requirement of having deferral accounts approved by an independent third-party regulator, or whether the government can create an asset from future unbilled and uncollected revenue.

The BC Public Accounts Committee Hearing

The provincial PAC met on 30 January 2018 to review Auditor General Carol Bellringer's three qualifications to the government's 2016/17 financial statements.⁶ Two of them were continuing disagreements with the government about the treatment of cost sharing revenue and the self-supporting status of a certain Crown corporation. The new qualification was based on Ms Bellringer's opinion that the rate regulated accounting standard used at BC Hydro does not conform to public sector accounting standards because the regulator is not independent.⁷

Rather than the battery of top public servants that attended the Ontario PAC, the government was represented by Carl Fischer, the acting comptroller general.

Mr. Fischer defended the use of rate-regulated accounting at BC Hydro by saying, in effect, that cabinet was performing the role of the regulator envisioned in the accounting standard. He also noted that as the government's chief accountant he must follow the legislation and cabinet regulation, rather than the accounting opinion of the auditor general; "you have to make a choice of whether or not you are going to take the advice of the Auditor General or follow legislated requirements. Quite frankly, being employed by government, legislation wins."⁸

Much of the questioning by members of the PAC was directed to increasing the knowledge of new members. Specific responses to what the effect on the surplus/deficit position would be if the Hydro deferral accounts were adjusted to conform to the national public sector accounting standard was postponed to a more detailed report that the auditor general promised for later in 2018.

Committee chair Shirley Bond, a senior member of the former government, stated that she believed that accounting policy choices made by the previous government that affected the financial bottom line, such as rate-regulated accounting, may be changed by the new government. She concluded the session by stating that the reconciliation of current practice with the opinion of the auditor general was a work in progress.

⁶ <https://www.leg.bc.ca/documents-data/committees-transcripts/20180130am-PublicAccounts-Vancouver-Blues>

⁷ http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_44_26_october_2017/pdf/occasional_paper_no_44_26_october_2017.pdf

⁸ <https://www.leg.bc.ca/documents-data/committees-transcripts/20180130am-PublicAccounts-Vancouver-Blues>

SUBSEQUENT DEVELOPMENTS

In March, Auditor General Lysyk reported concerns uncovered during a special and critical audit of IESO.⁹

The Ontario media have been reporting that the government achieved a balanced budget for 2017/18 despite the Auditor General Lysyk's opinion that the expenditures are understated.¹⁰

Auditor General Bellringer is also adopting a more active approach. She has secured the backing of the PAC to begin taking over the role of external auditor of BC Hydro in fiscal year 2018/19, with full responsibility the following year.

SUMMARY

The approach to reviewing the qualification by the two auditors general to the financial statements is markedly different in Ontario and BC. This may be due to the importance of electricity pricing to the Ontario government that is low in the polls leading to an election, compared to the situation of a new government in this province that is still struggling to understand the full implications of rate-regulated accounting at BC Hydro for the government's healthy financial position.¹¹

The fundamental issue is the same in both jurisdictions: should government ignore the opinion of the Legislature's independent auditor and adjust accounting standards which result in electricity rates that benefit current customers (and by inference assists the government's approval rating), or should government, including its Crown corporations, operate within the limits of generally accepted national public sector accounting standards?

©Richard McCandless March 28, 2018

<http://www.bcpolicyperspectives.com/>

The writer is a retired senior BC government public servant whose paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 was published by *BC Studies* in November 2016. *BC Studies* published his paper on the 40-year financial history of ICBC in 2013. He has been an intervener in the BC Utilities Commission's recent reviews of both ICBC's and BC Hydro's rate requests.

⁹ <https://www.theglobeandmail.com/canada/article-auditor-general-blasts-bogus-hydro-accounting-strategies-in-ontario/>

¹⁰ <https://www.theglobeandmail.com/canada/article-b2018-ontario-budget-liberals-go-into-the-red-with-billions-in/>

¹¹ The ill-advised on the attempt to transfer the impact of a 3% rate freeze to future generations is an example.

