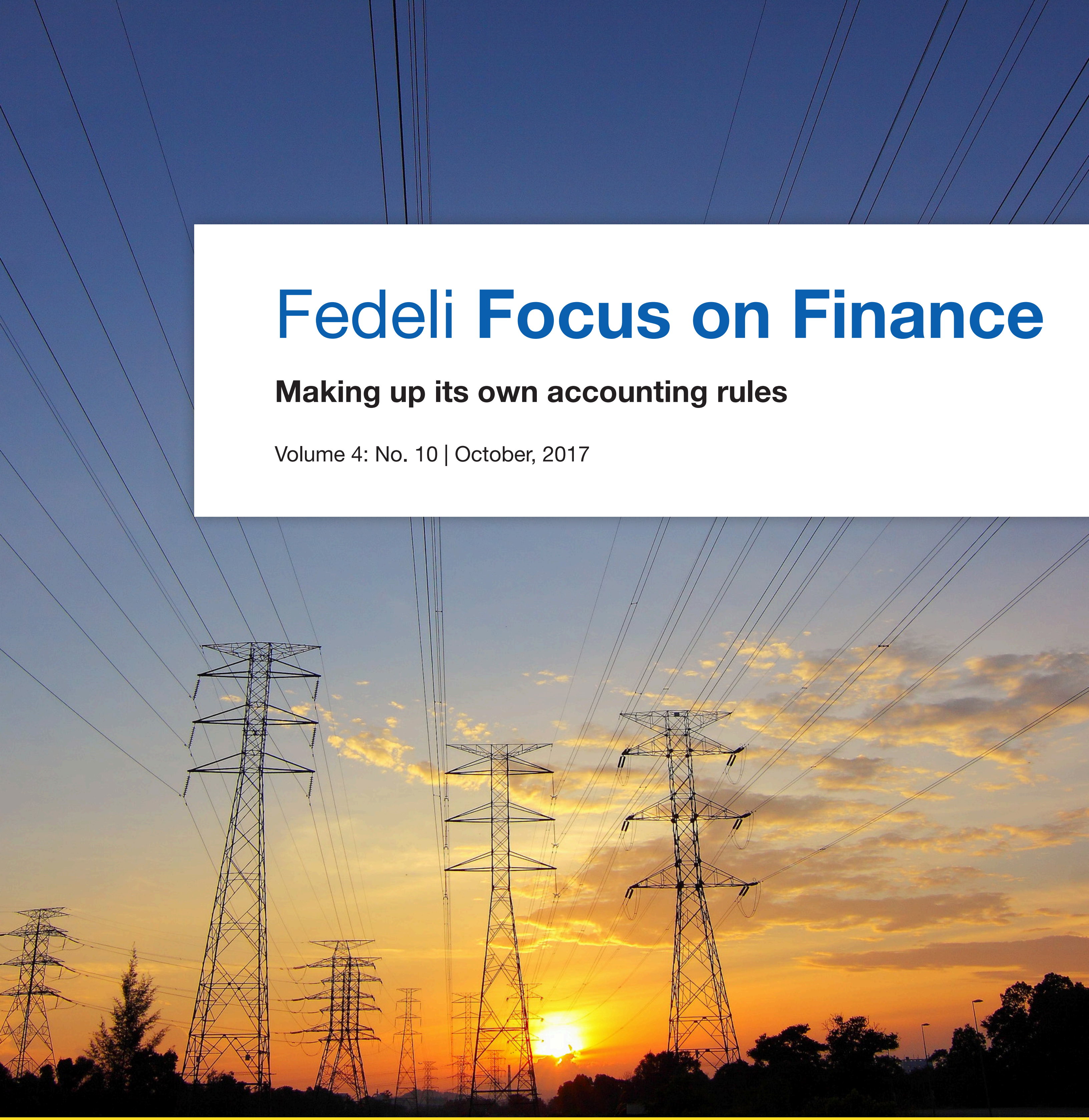


Fedeli **Focus on Finance**

Making up its own accounting rules

Volume 4: No. 10 | October, 2017

Ontario

Vic Fedeli MPP DÉPUTÉ
NIPISSING

Making up its own accounting rules

For the second consecutive month, both the Auditor General and the Financial Accountability Office have released very alarming reports about the true state of Ontario's finances.

This is important to acknowledge as the divide between what the independent Legislative officers are presenting and what the government is offering, is growing wider. The numbers the officers are presenting are vastly different than the numbers the government is offering. In accounting, this simply shouldn't be.

Recall last month's issue of *Focus* revealed that the Financial Accountability Office (FAO) presented a report concluding the government's debt reduction commitment was based on "unlikely assumptions." And the Auditor General (AG) responded to the government's financial statements by issuing a "qualified" audit opinion because, based on the evidence, the statements were "significantly misstated." The government's response, once again, was to attempt to disparage the Auditor General.

This month, further "concerns about fiscal transparency, accountability, and value for money" were presented by the Auditor, with respect to the so-called Fair Hydro Plan. I will summarize what's in the AG's 53-page report, and break it down for you.

The Issue

As with many reports, the title, *Fair Hydro Plan: Concerns About Fiscal Transparency, Accountability, and Value for Money*, reveals what to expect. If there's any doubt, the opening paragraphs, written by the AG, add an exclamation point: "When governments pass legislation to make their own accounting rules that serve to obfuscate the impact of their financial decision, their financial statements become unreliable." And, "When organizational structures and transactions are designed to remove transparency and accountability, and unnecessarily cost Ontarians billions of dollars, the responsibility of an Auditor General is to apprise the Legislature and the public in accordance with the Auditor General mandate."

At play here is the government's so-called Fair Hydro Plan, announced as a 25% reduction in hydro bills. Over many months we've learned this will cost anywhere between \$45 billion and \$93 billion, depending on how much the government has to borrow over the next 29 years. That much we knew going in. What the Auditor General has revealed is that **the government created a complicated financing structure, designed to keep the true cost of the Plan off the Province's books, so as not to show a deficit or increase debt. And, that this decision could cost Ontarians \$4 billion more in interest costs, as the off-book structure doesn't have the same borrowing power as the Province.**

In the AG's Words

It's important to see exactly what the Auditor General wrote, so you can determine just how serious this is, from a financial perspective and a moral/ethical perspective.

The AG opens with "the accounting rules being applied are actually not in accordance with Canadian Public Sector Accounting Standards (PSAS)." As an independent, non-partisan Office of the Legislature, AG Bonnie Lysyk felt it her "responsibility to speak out when the financial information of the government is not, or will not be, presented fairly and transparently to both the Legislature and Ontarians."

In the Summary of Concerns, we learn that "it is clear that the government's intention in creating the accounting/financing design to handle the costs of electricity rate reduction, was to avoid affecting its fiscal plan. That is, the intention was to avoid showing a deficit in the Province's budgets and consolidated financial statements, and to likewise show no increase in the Provincial net debt."

While the AG does not question the government's policy decision to reduce electricity bills, her concerns are that the "planned accounting for the government's budgets and consolidated financial statements is incorrect, and that it was known that the planned financing structure could result in significant unnecessary costs for Ontarians."

The substance of the issue is straightforward. The government has reduced hydro bills, making them lower than the actual cost. However, the power generators still need to be paid, so the government will borrow cash to cover the shortfall. That additional money needs to be accounted for as part of the annual deficit and net debt. However, the AG says "the government did not properly account for this debt … and is not planning to account for it properly." **"In essence, the government is making up its own accounting rules."**

The Special Report adds the following key concerns:

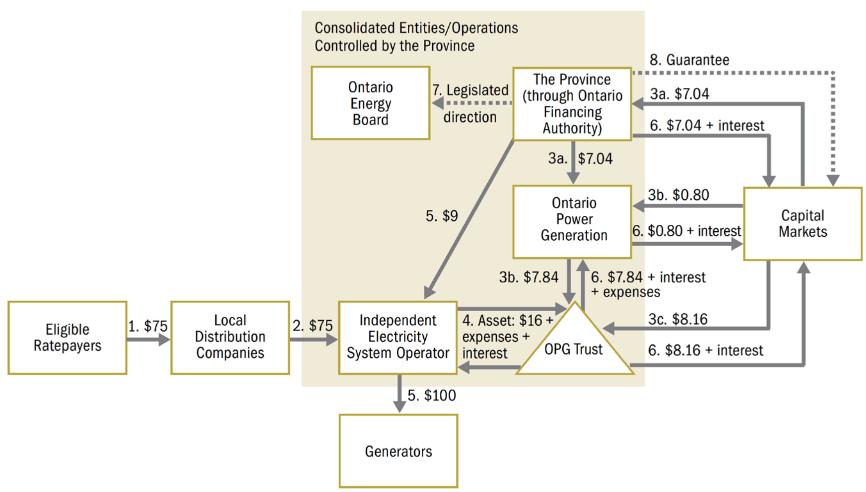
- The government created a needlessly complex accounting/financing structure in order to avoid showing a deficit or an increase in net debt
- To pay back the borrowings, from 2028 on, ratepayers will be charged more than the actual cost of electricity being produced
- Those borrowings are estimated at approximately $40 billion, including $4 billion in extra interest charges (extra because some of the money would be borrowed at a higher rate by OPG)
- They are doing this by creating a 'regulatory asset' (more on that later)
- The creation of a regulatory asset violates the government's own accounting policies developed within Canadian PSAS
- The government knew there was a high risk this would trigger a "qualified" audit opinion, but accepted this risk in order to avoid showing a deficit and an increase in net debt

To summarize the Auditor's report, "the government made a critical decision early in the process of setting out the details of the Fair Hydro Plan: the accounting treatment should not affect the fiscal plan – that is, it should not show any deficit incurred from this required borrowing, nor should it add to the amount the government would report as Ontario's net debt." This was set as the mandate to senior officials and private-sector external advisors, who worked for months to achieve this political goal. In addition, they spent considerable funds; more than $2 million on advisors and a $500,000 legal retainer for a firm to vet e-mails before turning them over to the AG. (They *still* haven't turned them all over). However, as indicated in the AG's report, the accounting advisors confirmed in discussions that "their opinions regarding the financial reporting of individual entities such as the IESO, OPG and OPG Trust do not extend to the Province's consolidated financial statements."

In the end, the government decided on a very complex form to achieve "the mandate to avoid recording an annual deficit and an annual increase in net debt." The Independent Electricity System Operator (IESO) sells the revenue shortfall to a newly-created OPG Trust as if it were an asset, and pays the power generators their full amount owed. They call the shortfall or net expense, a "regulatory asset". In a complex series of transactions, which the Report carefully outlines over several pages, the AG concludes "the end result of the accounting design is that the financial statements for the IESO, OPG, and OPG Trust, as well as the consolidated financial statements for the

Figure 2: The Form of the Planned Accounting/Financing Transactions

Prepared by the Office of the Auditor General of Ontario



This chart was prepared by the Office of the Auditor General. It shows just how convoluted and confusing the structure developed by the government is.

Province, will NOT show any bottom-line impact for the costs of the government's policy decision." "The 'asset' being legislated into existence does not meet the accounting requirements for an asset on the Province's consolidated financial statements, which are prepared following Canadian PSAS." "Accounting that creates an asset to avoid impacting net debt is contrary to the Canadian PSAS framework."

Conclusion

Through legislation, the government created their own accounting asset. They simply legislated the loss at IESO, as a "regulatory asset". If governments are allowed to call losses "regulatory assets", <u>we'll never have deficits again</u>.

It's shameful to listen to the government attempt to justify this as some sort of normal accounting procedure. They use U.S. private-sector accounting examples to justify what they did. The U.S. framework is entirely different than Canadian PSAS – we stress net debt; U.S. standards don't have a net debt model. Besides, if the government thought this was OK to do, why didn't they just ask the AG about it in the beginning?

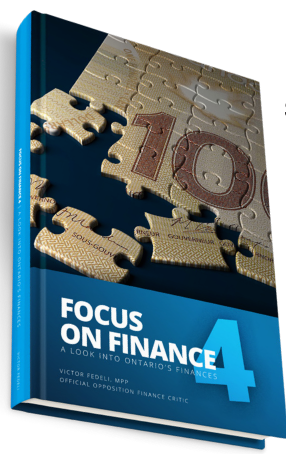
Nonetheless, this isn't even an accounting issue – it's a devious political decision. The government had hundreds of people working on this since January, and spent millions, all to concoct a scheme to keep the immense impact of their policy decision off of the government's books. They knowingly risked receiving a "qualified" opinion, and the entire Cabinet knew it would cost several billions more to do it this way, but proceeded anyway.

Key Questions

As the government agrees there would be higher interest costs, yet denies it will add $4 billion, what is their number?

Does the government have an opinion from outside auditors on how this transaction should be recorded in their Consolidated Financial Statements?

Does the government plan on creating more "regulatory assets" or any other inappropriate legislated accounting schemes in the future?



Similar stories of waste, mismanagement, and scandal are disclosed in my new book, ***Focus on Finance 4***.

Please go to **www.fedeli.com** to download your own copy of the book.

Please feel free to SHARE this report with as many people as you can!

If you would like to read previous issues of Focus on Finance, please go to www.fedeli.com or email us and we'll add you to our electronic mailing list.

Ontario

Vic Fedeli MPP DÉPUTÉ
NIPISSING

Constituency Office:
165 Main Street East
North Bay, Ontario P1B 1A9

Tel: **705-474-8340**
Fax: **705-474-9747**
vic.fedelico@pc.ola.org

www.fedeli.com

Queen's Park Office:
Room 347, Main Legislative Building, Queen's Park
Toronto, Ontario M7A 1A8

Tel: **416-325-3434**
Fax: **416-325-3437**
vic.fedeli@pc.ola.org