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Reprint from Volume 22 Number 16

Sep 2, 2010

When is a loss a profit? Auditor General questions BC Hydro accounting

Patrick Brown

The provincial Auditor-General has questioned BC Hydro's use of 'rate-regulated' accounting and the consolidation of the resulting reported revenues into the provincial accounts.

BC Hydro's various cost deferrals, many resulting from provincial cabinet 'Special Directions', have had the effect of changing BC Hydro's operating loss of \$249 million into a profit of \$447 million for fiscal 2010—an adjustment of \$696 million. This is \$696 million that otherwise would have to have been added to the provincial budget deficit.

Why BC Hydro is Losing Money

Over the past few years, BC Hydro has experienced a reduction in provincial electricity consumption, drastic reductions in trading revenues, lower water flows in its hydroelectric facilities, increased electricity purchase quantities (at higher costs per unit) from independent power producers (IPPs), and a massive capital program. It is borrowing large amounts of money.

BC Hydro is also restricted as to how much it can increase its electricity rates to the consumer because its 'return on equity' is limited by the BC Utilities Commission to a percentage equivalent to what BCUC allows to the nearest privately owned utility, Terasen Gas. (BCUC sets domestic electricity prices in its decision on the annual 'Revenue Requirements Application' (RRA) made by BC Hydro).

In addition, BC Hydro has been required by the provincial government to take on massive liabilities (estimated at \$30-50 billion) for 'take or pay' contracts with IPPs, now and long into the future.

Indications are that while the current spot market price for electricity is around \$60/per MWh, BC Hydro is contracting for new IPP power at rates around \$133.80 for firm power, and \$76.20 for non-firm, or intermittent,

power. And in fiscal year 2010, which ended March 31, 2010, BC Hydro got 16% of its power from IPPs.

In the fiscal year ending March 31, 2010, BC Hydro incurred operational losses in four major operations categories: Heritage Power, Non-Heritage Power, BC Transmission Co, and Trade Income (the largest, over \$200 million). It is not clear whether these losses resulted from lower revenues than forecast, or from higher costs. But in all four, Special Directions from the provincial cabinet required that the losses be deferred.

The Auditor General's Concerns

The Auditor General expressed two main concerns with this form of bookkeeping. The first is that the BC Utilities Commission authorizes the use of 'regulatory' deferral accounts to 'defer and amortize over a number of years those costs that would otherwise have to be expensed in one year.' He notes: '...the government is also able to give special direction to the utilities commission that can affect the profitability of the regulated entities.'

The second concern is that: although current Canadian accounting standards allow the use of 'rate regulated' accounting only until the end of December, 'The provincial government recently amended the *Budget Transparency and Accountability Act* effective April 1, 2010.... This could result in the government choosing to use rate regulated accounting, even beyond 2013.'

The Auditor General reports that he has been examining the impact of the regulatory accounts on BC Hydro's earnings totals. He also notes that 'BC Hydro also holds unamortized net regulatory assets of \$1,713 million. These regulatory assets are, in effect, expenses that have been deferred to future years.'

International Financial Reporting Standards

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This article was published (Sep 2, 2010) in 'Island Tides'. 'Island Tides' is an independent, regional newspaper distributing 18,000 print copies throughout the Gulf Islands and Vancouver Island from Victoria to Campbell River.

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The Auditor-General goes on to say: 'BC Hydro and other commercial Crown corporations are government business enterprises and as such are required by the Public Sector Accounting Board to transition to International Financial Reporting Standards (IFRS) effective January 1, 2011.

Current IFRS standards do not allow for the use of rate regulated accounting. Under current IFRS, BC Hydro would have to expense many of the transactions it now accounts for as rate-regulated assets.' (The IFRS rules may change. The most recent IFRS draft would provide for the use of regulatory accounts.)

He indicates his concern about the provincial government's ability to choose whatever accounting standards they prefer: 'We will monitor whether or not government uses the legislated amendments to the *Budget Transparency and Accountability Act* to re-define GAAP (Generally Accepted Accounting Principles, the current standard) in the provincial government reporting entity.'

He concludes: 'It is also common practice for an organization to consult its auditors when the organization is contemplating changing its accounting policies. We request that the government consult with the Auditor General before implementing any significant accounting changes.'

A special report on BC Hydro's accounting practices will appear in the next edition of Island Tides. ✍