Estimates – Energy: Friendly Questions

Topic: IESO Accounting of Fair Hydro Plan - IESO

1. Independent Electricity System Operator (IESO) Accounting Change

Question:

Before we dive into the accounting minutia, maybe you can start off by explaining the IESO's role in the sector, its business operations, the types of accounts it holds?

Answer:

- Of course.
- My name is Kimberly Marshall, I'm the Chief Financial Officer and Vice-President of Corporate Services at the Independent Electricity System Operator.
- The Independent Electricity System Operator is the public agency at the heart of Ontario's electricity system. We have a broad mandate that includes:
  - planning to meet Ontario's electricity needs in the near- and long-term;
  - reliable operation of the provincial electricity grid;
  - administering Ontario's wholesale electricity market;
  - fostering a culture of conservation; and in doing all of this;
  - engaging with stakeholders and communities across the province.
- In our role as market administrator, we oversee all wholesale electricity market transactions. Through this market, money is constantly flowing to and from market participants, such as generators, like OPG and distributors, like Toronto Hydro.
- As a not-for-profit entity, our role is to efficiently manage and facilitate these market transactions.
- This may sound fairly straightforward, but to give you an idea of the value of transactions in our market, last year we settled about 17 billion dollars of financial transactions.

- The IESO is an organization that wears many hats in the sector, too. For example, the IESO is designated as Ontario's Smart Metering Entity or SME.
- In our role as Ontario's SME, we maintain and operate the province's smart meter data repository that processes, stores and protects electricity consumption data used for consumer billing by Ontario's local distribution companies.
- The SME operates under licence by the Ontario Energy Board (OEB). In its role as the SME, the IESO is responsible for the implementation, integration and operation of province's Metering Data Management/Repository (MDM/R).
- The SME and distributors operate under the Smart Metering Agreement for Distributors that sets out their respective roles and responsibilities related to smart metering, the MDM/R and the exchange of information.

- As the SME, we incur certain expenses related to Ontario's electricity system that are not directly recovered through normal revenue requirement models – instead, they are recovered through rate-regulation.
- Basically, we incur expenses that we have a right to recover later on, through an Ontario Energy Board-regulated Smart Metering Entity charge.
- The IESO's previously recorded no regulatory asset as the Smart Metering Entity.

2. Explain the Accounting Change

Question:

Can you please provide the committee members with more details on the accounting change?

Answer:

- The IESO regularly reviews its accounting policies to ensure that they provide transparent and relevant financial reporting that most accurately represents the IESO's assets and liabilities and meets the needs of its financial statement users.
- Through a recent review of our accounting policy with our external auditor – accounting firm, KPMG – the IESO determined that there were reporting options for market accounts and rate-regulated assets and that a choice was required as to whether or not to report these in the IESO financial statements.
- We checked with government and our external auditors to ensure tat the accounting policy changes we were considering would also align with the contemplated Fair Hydro Plan Act, at the time.
- After thorough consideration with IESO senior management and Board, and engagement with our external auditors, the IESO decided to implement two changes to its accounting policy:
    - First, to record the market accounts assets and liabilities – the amounts due to and from market participants held on behalf of the IESO-administered markets – in its statement of financial position, and;
    - Second, to recognize regulated assets, such as the IESO's future right to recover the Smart Metering Charge.

3. Reason for Reporting Market Accounts

Question:

Could you please explain what 'market accounts' are, and why you decided to begin reporting them as part of your accounting policy?

Answer:

- In its role as Ontario's electricity market administrator, the IESO operates and settles approximately 17 billion dollars through the electricity market every year.

- In our market, money is constantly flowing to and from market participants, such as consumers and generators. This role requires the IESO to temporarily hold and transfer money between market participants – like Local Distribution Companies and generators.
- The substance of these transactions was previously unreported on the IESO's financial statements.
- The change to include market account assets and liabilities on our financial statements provides increased transparency into the value of transactions that flow through Ontario's electricity market.

4. Reason for Adopting Rate Regulated Accounting

Question:

Could you please explain what this new regulatory accounting entails, and provide more details on why the IESO decided to adopt this method of accounting?

Answer:

- The change to rate regulated accounting better reflects the economic substance of certain types of IESO expenses (like SME expenses) that may not be directly recovered through normal revenue requirement models, and instead are recovered through rate regulation, meaning that the rate is regulated by the Ontario Energy Board.
- Regulated assets are a way of reporting the IESO's right to collect an amount, in the future.
- Here's an example, as the province's Smart Metering Entity, we incur certain expenses related to Ontario's electricity system that are not directly recovered through normal revenue requirement models – instead, they are recovered through rate-regulation.
- Basically, we incur expenses that we have a right to recover later on, through an Ontario Energy Board-regulated Smart Metering Entity charge.
- The IESO's regulated assets as they pertain to our role as the Smart Metering Entity were also previously unreported on our financial statements.
- This change is in line with accounting practices followed by other independent system operators in North America.

5. Reason for Accounting Change

Question:

Can you please explain why the IESO changes its accounting policy? Is this a regular practice?

Answer:

- The IESO regularly reviews its accounting policies.
- Prompted by conversation with government about the Fair Hydro Plan, the IESO revisited its options for reporting market accounts and recognizing regulatory assets.

- Working with its audit partner KPMG, the IESO determined that there were reporting options for market accounts and that a choice was required as to whether or not to record market accounts assets and liabilities in the IESO financial statements.
- By analyzing the nature of the accounts, IESO's economic relationship to them, legislative requirements and market rules it was concluded that an appropriate position for either treatment was acceptable.
- Ultimately, the IESO felt the public reporting of market accounts was relevant to the needs of its financial statement users and enables greater transparency into the market transactions it oversees, which amounted to $17 billion last year.
- This change to recognize regulated assets and market accounts brings the IESO in line with accounting practices followed by other independent system operators in North America.
- The Ontario Power Authority, a predecessor organization of the IESO, reported a subset of the market accounts on its financial statements.

6. Steps to Verify Accounting Change

Question:

What steps did the IESO take to verify that the accounting changes were appropriate for the organization? Did you consult with any third parties on the issue?

Answer:

- First, the IESO's senior management team considered the accounting policy changes to increase transparency of its $17 billion annual market transactions, the substance of the variance accounts it holds and its right to collect an amount in the future – as with regulatory assets.
- To confirm that the change was appropriate, the IESO engaged KPMG for accounting research to support their advice and guidance on our accounting policy change. They noted six of eight other system operators in North America use regulatory accounting and seven out of eight system operators in North America recognize the balances of the market participants.
- Then, KPMG issued a white paper on the accounting change, supporting the IESO's decision to change its accounting policy. The changes were also reviewed with and supported by the Office of the Provincial Controller.
- The accounting change was reviewed by the IESO's Board of Directors, and approved.
- As a part of the year-end audit, KPMG issued an accounting opinion on the matter. The accounting firm issued an unqualified accounting opinion, meaning they supported the decision.
- In order to communicate the change of accounting policy, the IESO added additional notes in its 2016 financial statements to explain the changes in the Summary of Significant Accounting Policies section of its 2016 annual report.

7. Public Sector Accounting Standards

Question:
Is the change to recognize regulated assets permitted under Public Sector Accounting Standards (PSAP), the accounting standard for public sector entities?

Answer:

- PSAS neither explicitly permits, nor prohibits, 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 is entitled to consult another accounting standard.
- In this case, the IESO consulted US GAAP, the only accounting framework in North America that provides guidance on rate regulated operations. The IESO has since adopted aspects of the US GAAP accounting framework allowing the IESO to recognize a regulatory asset.
- This decision was supported by an accounting opinion from our external auditors at KPMG and aligns the IESO with six of the eight other independent system operators in North America.
- In fact, more than one of the big accounting firms agree with our decision on this matter.

8. Other Jurisdictions

Question:
How does the IESO's accounting policy compare to its peers in this regard?

Answer:

- In addition to the IESO, there are eight other independent system operators in North America. The accounting policy change implemented by the IESO brings it in line with most of its peers.
- Six out of eight other independent system operators in North America currently recognize regulatory assets. Seven out of eight recognize the balances of market participants.

9. Effect on Ratepayers

Question:
Will these accounting changes impact electricity ratepayers?

Answer:

- These changes in no way affect the IESO's costs, or have any financial impact on electricity ratepayers.
- Ultimately, the IESO made these changes because it will provide the users of its financial statements greater transparency into the market transactions it oversees, which amounted to $17 billion last year, and better reflects the economic substance of IESO expenses that are recovered through rate-regulation.