KPMG Letter to the Independent Electricity System Operator

An Accounting Opinion on the Application of PSAS to the Consolidation of a Trust, and to the Recognition and Derecognition of a Variance Account in Relation to the *Ontario Fair Hydro Plan Act, 2017*

NOTICE OF NON RELIANCE

This Notice is regarding the accompanying Letter to provide an accounting opinion on the application of Public Sector Accounting Standards to the consolidation of a trust, and to the recognition and derecognition of a variance account in relation to the *Ontario Fair Hydro Plan Act, 2017* (the "**Letter**") prepared by KPMG LLP for the Independent Electricity System Operator ("Client").

The following terms apply to any review of the Letter and should you not agree to these terms, please do not review the Letter and delete copy of the same.

The Letter was prepared in connection with certain services we provided to the Client and should not be used for any other purpose or regarded as suitable for use by any person or persons other than the Client.

No one other than the Client is authorized by KPMG to rely upon any information or views expressed in the Letter. Furthermore, no one other than the Client may use or quote from this opinion without our express written consent. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as the Letter has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

KPMG in no way accepts any duty of care to you or any other person or accepts any agreement or other arrangement of a contractually binding nature between our firm and such parties.

KPMG neither warrants nor represents that the Letter is accurate, complete, sufficient or appropriate for any purpose contemplated by you or any other person or body. You shall have no right to disclose the Letter to any other party.

Yours very truly,

KPMG LLP

KPMG LLP
Chartered Accountants
Bay Adelaide Centre
Suite 4600
333 Bay Street
Toronto ON
M5H 2S5

Telephone (416) 777-8500
Fax (416) 777-8818
www.kpmg.ca

February 12, 2018

CONFIDENTIAL

Independent Electricity System Operator
120 Adelaide Street West Suite 1600
Toronto, ON M5H 1T1

The Board of Directors

Dear Sirs, Madams,

We have been engaged to provide you with an accounting opinion on the application of Public Sector Accounting Standards to the consolidation of a trust, and to the recognition and derecognition of a variance account in relation to Bill 132, which on June 1, 2017 created the *Ontario Fair Hydro Plan* Act, 2017 (the "FHP Act") and its subsequent regulations (the "Regulations") and amended the *Electricity Act, 1998 (the "Electricity Act")* and the *Ontario Energy Board Act, 1998 (the "OEB Act")*. This letter is being issued to the Independent Electricity System Operator ("IESO" or the "Company") in connection with its evaluation of the consolidation requirements and the accounting for the variance account under Canadian Public Sector Accounting Standards ("PSAS"). The accounting opinion is specific to the accounting by the IESO and does not relate to the accounting by another entity, including the Province of Ontario. Our engagement has been conducted in accordance with generally accepted standards in Canada for such engagements.

The ultimate responsibility for the decision on the appropriate application of PSAS for the specific issues described below rests with management of the Company as preparers of the financial statements.

The following three issues are addressed in this letter:

Issue #1: Can the IESO apply the guidance in ASC 980 with respect to the FHP Act and the related variance account? Can the IESO recognize a regulatory asset related to the variance account created by the FHP Act?

Issue #2: Is the Fair Hydro Trust established by Ontario Power Generation Inc. (the "Trust") controlled by the IESO according to the guidance issued under PSAS 1300 *Government Reporting Entity* and therefore subject to consolidation by IESO?

Issue #3: What is the accounting treatment for the transfer of the regulatory asset by the IESO to the Trust? More specifically, does the transfer qualify as a derecognition event for accounting by the IESO?

Issue #1: Can the IESO apply the guidance in ASC 980 with respect to the FHP Act and the related variance account? Can the IESO recognize a regulatory asset related to the variance account created by the FHP Act?

Background for issue #1

The facts, circumstances, and assumptions relevant to the specific transactions as provided to us by the management of the Company (responsible party) are as follows:

1. The IESO's legal status is a not-for-profit, non-taxable, corporation established pursuant to Part II of the Electricity Act. Management of the IESO has determined that the Company is an *Other Governmental Organization* and accordingly prepares its financial statements in accordance with PSAS.
2. IESO is rate regulated by the OEB in accordance with the Electricity Act and the OEB Act. The regulated operations include the recovery of the operating expenses, the smart meter activities and the commodity price of electricity.
3. *Extract from the 2016 IESO financial statements, note 3 New Accounting Policies.* "As of January 1, 2016, the IESO changed its accounting policy regarding the recognition of assets and liabilities subject to rate regulation. The change was made to better reflect the economic substance of certain types of current and future expenses that may not be directly recovered through the normal revenue requirement model. This change has been applied retroactively and has increased amounts previously unrecorded for regulatory assets and decreased amounts previously reported for accumulated deficit."
4. *Extract from the 2016 IESO financial statements, note 2(d) Summary of Significant Accounting Policies, Regulatory assets and liabilities.* "As a rate-regulated entity, the IESO, in appropriate circumstances establishes regulated assets or liabilities and thereby defers the impact on the statement of operations of certain expenses or revenues because they are probable to be collected or refunded to market participants through future billings. The IESO applies guidance from United States Generally Accepted Accounting Principles (US GAAP) Topic 980, *Regulated Operation*s *("ASC 980")*, in this policy."
5. In its 2016 financial statements, IESO recognized two regulatory assets for unrecovered smart metering expenses and unrecovered PSAB transition items as permitted by rates approved by the OEB. In accordance with section 25.33 of the Electricity Act, IESO also recognized a regulatory asset (i.e. RPP variance account) to record all amounts receivable by it in connection with the amounts under collected from RPP consumers. Furthermore, in accordance with the OEB Act, IESO recognized a regulatory asset (i.e. RRRP variance account) and liability (i.e. OESP variance account) to record all amounts payable or receivable by it in connection with amounts under the OESP or RRRP program.
6. Relevant sections from the Electricity Act

   Section 25.33 Electricity pricing to reflect costs

   (1) *IESO to make adjustments*: The IESO shall, through its billing and settlement systems, make adjustments in accordance with the regulations that ensure that, over time, payments by classes of market participants in Ontario that are prescribed by regulation reflect,

      (a) amounts paid to generators, the Financial Corporation and distributors, whether the amounts are determined under the market rules or under section 78.1, 78.2 or 78.5 of the Ontario Energy Board Act, 1998;

      (b) amounts paid to entities with whom the IESO has a procurement contract, as determined under the procurement contract; and

KPMG

(c) such amounts as may be prescribed that are paid or incurred by the IESO in relation to the Ontario Fair Hydro Plan Act, 2017.

(3) *Exception*: Any adjustment that would otherwise be made under subsection (1) or (2) and that relates to electricity that is consumed by any of the following types of consumers shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO:

2. A consumer whose rates are determined by the Board under section 79.16 of the Ontario Energy Board Act, 1998.

3. A consumer who is a member of a class of consumers prescribed by the regulations.

(4) *Adjustments, payments, set-offs and credits*: The IESO, distributors and retailers shall,

(a) make such adjustments in their accounts as may be required or permitted by the regulations to record adjustments described in subsections (1), (2) and (3); and

(b) make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in subsection (3) or as may be required by a regulation made under this Act or the Ontario Fair Hydro Plan Act, 2017.

(5) *Variance account*: The IESO shall establish and maintain such variance accounts as may be necessary to record all amounts payable or receivable by it under this section or under the Ontario Fair Hydro Plan Act, 2017.

(6) *Compliance*: The Board shall ensure that adjustments, payments, set-offs and credits required or permitted under this section are made in accordance with the regulations.

7. Relevant sections from the OEB Act

Section 78 Orders by Board, Electricity rates

(2.1) *Order re the Smart Metering Entity*: The Smart Metering Entity shall not charge for meeting its obligations under Part IV.2 of the Electricity Act, 1998 except in accordance with an order of the Board, which is not bound by the terms of any contract.

(3.3) *Rates to reflect cost of electricity*: In approving or fixing rates under subsection (3.1),

(a) the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration the adjustments required under section 25.33 of the Electricity Act, 1998 and shall ensure that the rates reflect these costs.

8. Relevant sections from the FHP Act

Section 1 Interpretation, Transfer of regulatory asset

(3) In this Act, a reference to the transfer of a specified portion of the regulatory asset is a reference to the following, as provided for in subsection 26 (3):

1. A reduction in the balance in the variance account.

2. The adjustment of the regulatory asset.

3. The acquisition by a financing entity of the investment interest corresponding to the specified portion of the regulatory asset.

Section 7 Regulated rate consumers

(1) *First adjustments*: Despite clause 79.16 (1) (b) of the Ontario Energy Board Act, 1998, the electricity rates payable by regulated rate consumers for the period beginning on July 1, 2017 and ending on April 30, 2018 are the rates determined by the Board under this section and in accordance with the regulations.

Section 8 Other specified consumers

(1) *First adjustments*: For the period beginning on July 1, 2017 and ending on April 30, 2018, the adjustments made under section 25.33 of the Electricity Act, 1998 shall, with respect to specified consumers who are not regulated rate consumers, be further adjusted by electricity vendors in accordance with the regulations and in accordance with the determinations made by the Board in accordance with the regulations.

Section 9 Determinations by Board

The Board shall make the determinations mentioned in sections 7 and 8 no later than 15 business days after the day this section receives Royal Assent and, regardless of whether the Board makes the determinations before or after July 1, 2017, the determinations shall be effective as of July 1, 2017.

Section 11 Subsequent adjustments

(1) Despite clause 79.16 (1) (b) of the Ontario Energy Board Act, 1998 and subject to subsection (2), the Lieutenant Governor in Council may prescribe methodologies to be applied by the Board after April 30, 2018 for the purpose of determining,

  (a) electricity rates for regulated rate consumers; or

  (b) further adjustments to be applied by electricity vendors, in accordance with the regulations and in accordance with the Board's determinations, to the adjustments made under section 25.33 of the Electricity Act, 1998 in respect of specified consumers who are not regulated rate consumers.

Section 24 Variance account to be established, maintained

(1) IESO shall establish and maintain a variance account in which it records the following:

  1. The IESO deferral for each month.
  2. All payments received by IESO resulting from the exercise of the right of recovery under section 25 and any transfer under section 26.
  3. Such other adjustments as may be prescribed, including adjustments in respect of the period that commences on or after May 1, 2017 and before the day this section comes into force.

(2) Subject to the correction of any obvious error by the IESO, its recording of the balance in the variance account is determinative of the balance as of the time of the recording.

(3) No change made by IESO to the balance in the variance account shall, if the previous balance was relied upon by an investment interest owner in the context of a transfer under section 26, affect the rights acquired by the investment interest owner under the transfer.

Section 25 Regulatory asset established

(1) Effective May 1, 2017, the IESO has the right, exercisable in accordance with this Act and the regulations, to recover the balance recorded in the variance account from specified consumers.

(2) Subject to subsection (3), the Board shall, from time to time and in accordance with the regulations, determine and set rates payable by specified consumers to allow for the IESO to recover the balance recorded in the variance account.

(3) IESO shall not be entitled to collect all or part of the balance recorded in the variance account from specified consumers before May 1, 2021.

Section 34 Board's Authority

(1) Each electricity vendor, the IESO and the Financial Services Manager shall maintain such accounts and provide such information to the Board as the Board may require for the purposes of carrying out its responsibilities under the FHP Act, in the form and manner and within the time required by the Board.

(2) Despite anything to the contrary in the OEB Act, the Board may exercise any of its responsibilities under this Act without a hearing.

9. Relevant sections from the Ontario Regulations 206/17

Section 9.1 IESO to pay, remit amounts re carrying costs of financing entity

(1) During the period beginning on December 1, 2017 and ending on July 31, 2021, the IESO shall pay and remit to a financing entity any amounts charged to the IESO by the financing entity in respect of carrying costs of the financing entity during the period beginning on June 1, 2017 and ending on July 31, 2021.

(5) The IESO may grant security to a financing entity in order to secure its obligations to pay and remit present and future amounts due under this section.

Section 16 Adjustments that may be recorded by the IESO

For the purposes of paragraph 3 of subsection 24 (1) of the Fair Hydro Plan Act, the IESO shall record the following adjustments in a variance account each month:

1. All funding rebates and other amounts paid by the IESO to a financing entity during the month.
2. Any variance account balances in variance accounts established and maintained under subsection 25.33 (5) of the Electricity Act, 1998 and costs incurred in relation to the balances.
3. Any amounts paid or incurred by the IESO under section 9.1.

10. It is expected that the IESO deferral recorded by the IESO in the variance account (the regulatory asset) will be transferred to an investment interest owner (i.e. initially the Fair Hydro Trust, a trust established by OPG) on a regular basis and cash collected from the Trust at the same time. The total IESO deferral for the period from May 1, 2017 to April 30, 2047 is estimated at $20 billion plus interest.

11. The IESO prepared an Ontario Planning Outlook (OPO) that informs the development of the 2017 Ontario Long-Term Energy Plan ("2017 LTEP"). Based on the 2017 LTEP issued by the Ministry of Energy, the demand for electricity is forecast to be relatively steady over the planning period (2017-2035). In the long-term, the IESO projects an increase in overall demand as electrification of the economy increases. During the planning period, the monthly residential bill for a typical customer (consumption of 750 kWh per month) will increase from $121 per month to $193 per month or an average annual increase by 2.6% before inflation.

Relevant Accounting Guidance for Issue #1

Relevant excerpts and application of ASC 980 *Regulated Operations* (the "Topic" or the "Regulated Operations Topic")

Topic 980-10-15: Scope guidance:

- Accounting requirements that are not directly related to the economic effects of rate actions may be imposed on regulated businesses by orders of regulatory authorities and occasionally by court decisions or statutes. This does not necessarily mean that those accounting requirements conform with generally accepted accounting principles (GAAP). For example, a regulatory authority may order an entity to capitalize and amortize a cost that would be charged to income currently by an unregulated entity. Unless capitalization of that cost is appropriate under this Topic, GAAP requires the regulated entity to charge the cost to current income. [980-10-05-7]
- Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP. [980-10-05-8]
- The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria:
  (a) 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.
  (b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form.
  (c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs. [980-10-15-2]
- The guidance in the Regulated Operations Topic does not apply to any of the following transactions:
  (a) Accounting for price controls that are imposed by governmental action in times of emergency, high inflation, or other unusual conditions, or accounting for contracts in general. However, if the terms of a contract between an entity and its customer are subject to regulation and the criteria of paragraph 980-10-15-2 are met with respect to that contract, the guidance in this Topic shall apply.
  (b) The criterion in paragraph 980-10-15-2(a) is intended to exclude contractual arrangements in which the government, or another party that could be viewed as a regulator, is a party to a contract and is the entity's principal customer. [980-10-15-7]
- The first scope limitation of paragraph 980-10-15-7 (which is paragraph 8 in FAS 71)—excluding accounting for price controls imposed by governmental action in times of emergency, high inflation, or other unusual conditions—was included in the Discussion Memorandum[1]. Price controls imposed in periods of unusual conditions are not expected to be applied consistently over an extended period. Indeed, their duration usually is limited by statute. In that environment, assurance of future benefits

[1] The Discussion Memorandum was the document exposed by FASB prior to the finalization of FAS 71.

cannot be provided by probable future actions of the price control regulator because that regulator may not exist at a given future date. [Paragraph 70 of the Basis for Conclusions of FAS 71]

- Incurred Cost - A cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for. [980-10-20]
- Failure of an entity's operations to continue to meet the criteria in paragraph 980-10-15-2 can result from different causes. Examples include the following:
  - (a) Deregulation.
  - (b) A change in the regulator's approach to setting rates from cost-based rate-making to another form of regulation.
  - (c) Increasing competition that limits the entity's ability to sell utility services or products at rates that will recover costs (as used in paragraph 980-10-15-2).
  - (d) Regulatory actions resulting from resistance to rate increases that limit the entity's ability to sell utility services or products at rates that will recover costs if the entity is unable to obtain (or chooses not to seek) relief from prior regulatory actions through appeals to the regulator or the courts. [980-20-15-2]

Topic 980-340-25: Criteria for recognition of regulatory assets:

- Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
  - (a) It is probable (as defined in [US GAAP Topic 450, *Contingencies*]) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
  - (b) Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.
- A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date. [980-340-25-1]

Topic 980: Other relevant provisions:

- Rate actions of a regulator can reduce or eliminate the value of an asset. If a regulator excludes all or part of a cost from allowable costs, the carrying amount of any asset recognized pursuant to paragraph 980-340-25-1 shall be reduced to the extent of the excluded cost. Whether other assets have been impaired shall be judged the same as for entities in general and the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 shall apply. [980-340-35-1]
- If at any time an entity's incurred cost no longer meets the criteria for the capitalization of an incurred cost (see paragraph 980-340-25-1), that cost shall be charged to earnings. [980-340-40-1]
- In some cases, a regulator may approve rates that are intended to recover an incurred cost over an extended period without a return on the unrecovered cost during the recovery period. [980-340-55-2]
- The regulator's action provides reasonable assurance of the existence of an asset (see paragraph 980-340-25-1). Accordingly, the regulated entity would capitalize the cost and amortize it over the period during which it will be allowed for rate-making purposes. That cost would not be recorded at discounted present value. An exception to this general rule is provided for costs of abandoned plants. [980-340-55-3]

Analysis of Issue #1: Can the IESO apply the guidance in ASC 980 with respect to the FHP Act and the related variance account? Can the IESO recognize a regulatory asset related to the variance account created by the FHP Act?

As noted above, as of January 1, 2016, the IESO changed its accounting policy to recognize the economic impacts of rate regulation and now applies guidance from US GAAP Topic 980, *Regulated Operations*, through the GAAP hierarchy under PS 1150, as PSAS does not have any specific guidance for entities with rate-regulated activities.

IESO concluded that it met the requirements of PS 2120.02, as it is considered that the change of accounting policy in its 2016 financial statements to reflect the impacts of rate regulation resulted in a more appropriate presentation of transactions in its financial statements. The change was made to better reflect the economic substance of certain types of expenses that may not be directly recovered through the normal revenue requirement model.

Up until the implementation of the FHP Act, most of the commodity price of electricity was collected by IESO from the local distribution companies through the customer billing, with any over or under collection being recorded in a variance account and reflected in the next RPP rate established by the OEB. As mentioned above, the effect of the FHP Act is to defer the timing of collection from specified consumers of a total estimated amount of $20 billion (plus interest) of the commodity price of electricity over an estimated 30-year period (as opposed to being in the year the electricity was consumed). The FHP Act does not permit IESO to collect the IESO deferral before May 1, 2021 and the recovery process has been established through regulations. Such a long-term deferred recovery plan requires IESO to consider whether it continues to meet the criteria that allow IESO to use the guidance for regulated operations of Topic 980, as well as to consider whether the uncollected amounts recorded in the variance account qualify for deferral as a regulatory asset. These two accounting issues are analyzed below.

Scope of Topic 980

Topic 980-10-05 provides background as to the intent of the accounting requirements. The background indicates that while regulators may provide for a variety of mechanisms to charge rates that are intended to produce revenue to cover allowable costs, these mechanisms are not determinative of the appropriate accounting:

– Accounting requirements that are not directly related to the economic effects of rate actions may be imposed on regulated businesses by orders of regulatory authorities and occasionally by court decisions or statutes. This does not necessarily mean that those accounting requirements conform with generally accepted accounting principles (GAAP). For example, a regulatory authority may order an entity to capitalize and amortize a cost that would be charged to income currently by an unregulated entity. <u>Unless capitalization of that cost is appropriate under this Topic, GAAP requires the regulated entity to charge the cost to current income</u>. [980-10-05-7] (Emphasis added)

In accordance with the FHP Act, a portion of the commodity price of electricity for specified consumers is being deferred (i.e., not charged to the specified consumer as the electricity is consumed) and the recovery of those costs will be included in a period other than the period in which the costs would otherwise be charged to expense. In fact, the difference between the amounts that would have been owed by specified consumers had the FHP Act not been enacted and the amounts collected from the specified consumers as a result of the FHP Act through the market participants is being recorded by the IESO in a variance account established pursuant to section 24 of the FHP Act. In accordance with Section 25 of the FHP Act, the OEB will regulate the timing of the recovery and set the rates to ensure that the IESO can fully recover the balance recorded in the variance account established pursuant to the FHP Act. Since the OEB regulation provides an economic effect on IESO, providing IESO with certainty as to the recoverability of the FHP Act variance account, it is not subject to the scope limitation. This is consistent with 980-10-05-8 which states:

- 980-10-05-8: "<u>Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general.</u> The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP." (Emphasis added)

Whether a variance account is created by legislation, regulation, court, statute or rate order issued by the OEB, the accounting requirement for the recognition of a regulatory asset is that the rate charged to customers must be designed to recover the specific entity's costs (i.e. the commodity price of electricity) of providing the regulated service provided that the capitalization criteria are met under 980-340-25-1 (see analysis below). This is supported by 980-10-05-7 and -05-8 (noted above), and 980-10-15-2 (b). The latter states that this criterion is intended to be applied to the substance of the regulation, rather than its form.

- The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form. [980-10-15-15-2 (b)].

Although the OEB has not yet approved the recovery of the balance recorded in the variance account, Section 25 of the FHP Act requires the OEB to set the rates payable by specified consumers to recover the balance recorded in the variance account and, therefore, it is probable that a specific recovery mechanism will be issued by the OEB. This legislation compels the OEB to set the rates and they have no discretion but to do so.

Before analyzing the criteria for the recognition of regulatory assets as prescribed by Topic 980-240-25, we need to address whether 980-10-15-7 (a) and (b) forbid the IESO from recognizing the economic effects of rate regulation.

- 980-10-15-7 (a) states "Accounting for <u>price controls</u> that are imposed by governmental action in times of emergency, high inflation, or other unusual conditions, or accounting for contracts in general. However, if the terms of a contract between an entity and its customer are subject to regulation and the criteria of paragraph 980-10-15-2 are met with respect to that contract, the guidance in this Topic shall apply."
- 980-10-15-7 (b) states "The criterion in paragraph 980-10-15-2 (a) is intended <u>to exclude contractual arrangements in which the government, or another party that could be viewed as a regulator, is a party to a contract and is the entity's principal customer."</u> (Emphasis added)
- Paragraph 70 of the Basis for Conclusions of FAS 71 states "The first scope limitation of paragraph 8 (which is paragraph 7 in ASC 980)—excluding accounting for price controls imposed by governmental action in times of emergency, high inflation, or other unusual conditions—was included in the Discussion Memorandum. Price controls imposed in periods of unusual conditions are not expected to be applied consistently over an extended period. Indeed, their duration usually is limited by statute. <u>In that environment, assurance of future benefits cannot be provided by probable future actions of the price control regulator because that regulator may not exist at a given future date</u>." (Emphasis added)

Therefore, there are two issues – first, are such economic events actually "price controls" or "contracts in general" and, second, if they are not, do such transactions meet the requirements of ASC 980 to be recognized in the regulated entity's general purpose financial statements.

With respect to the first issue, the OEB's rate setting process does not represent "price controls" as such term is intended to be applied in the standard. We note they have not been imposed in times of emergency, high inflation or other unusual conditions. Rather they have been applied in managing the timing of charging cost increases through to specified consumers for the commodity price of electricity. The FHP Act does not limit or control price increases, but rather defers the impact of specific costs for the stated period.

Said differently, this scope exemption in ASC 980 is intended to encompass situations where a regulator's response to unusual situations does not meet the hurdle of providing assurance of future benefits through probable future actions of that regulator and hence recovery of the specific entity's costs of providing the regulated services or products is uncertain. Such temporary measures are not done as part of a planned regulatory rate regime with a planned future recovery, but rather are done in the short-term without specific recovery expected. To conclude that the instant case is one of "price controls" would result in a conclusion that all rate setting processes are "price controls' which clearly is not the case.

With respect to the second part of the first issue, the fact that the energy contracts (defined as "procurement contracts" in the Electricity Act) have not been subject to prudence review by the OEB does not mean that the contracts are not subject to regulation. Determining whether the asset or group of costs (i.e. the energy contracts) is clearly specified in a rate order or other evidence that would support regulatory accounting, including the means and timing of cost recovery, is key to this analysis. Section 25.33 (1) states that the IESO shall, through its billing and settlement systems, make adjustments in accordance with the regulations that ensure that, over time, payments by classes of market participants in Ontario that are prescribed by regulation, reflect amounts paid (a) to generators, the OEFC and distributors, (b) to entities with whom the IESO has a procurement contract, and (c) in connection with the FHP Act. Section 25 of the FHP Act requires the OEB to set the rates payable by specified consumers to recover the balance in the variance account. Accordingly, we believe that the energy contracts are subject to regulation.

In addition, 980-10-15-7 (b) does not apply to IESO, as neither the Province of Ontario nor the OEB is the IESO's principal customer. The customers are the specified consumers mentioned in the FHP Act.

Further one would consider the guidance in 980-10-15-2, which is the subtopic which determines whether entities with regulated operations may apply "rate-regulated accounting".

Criteria for the application (and continued use) of ASC 980 guidance

In some jurisdictions, deferred recovery plans have been adopted by regulators or legislations enacted in response to significant increases in costs (e.g. purchased power costs). These plans typically provide for rates to remain fixed or increase moderately with a variance account mechanism to capture costs in excess of the level allowed in current rates. A regulated utility subject to such plans is required to consider whether it continues to meet the criteria that allow it to use the guidance for regulated operations of Topic 980, especially criteria ASC 980-10-15-2 (b).

The IESO's regulated plan for the recovery of the balance recorded in the variance account over an estimated 30-year period is considered a deferred recovery plan as the rates for the first four years will remain effectively fixed (subject to the rate of inflation) and subsequently the rates will increase moderately with a variance account to capture commodity price of electricity that is in excess of the level allowed in current rates.

The following is an analysis of the ASC 980-10-15-2 criteria as it applies to this arrangement both at its inception and on an ongoing basis.

Criteria	Comment	Evaluation
(a) 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.	IESO's rates for the regulated services provided to its customers are established by the OEB. IESO believes the OEB is an independent, third-party regulator to IESO. The IESO is subject to OEB's regular reviews and has no ability to influence the decisions issued by the OEB. Decisions issued by the OEB to the IESO have often denied the recovery of certain costs. The OEB states on their website the following, – *As Ontario's independent energy regulator, we make decisions and rules to ensure that consumers are treated fairly and that the energy sector is reliable and sustainable. We oversee how energy companies operate to ensure the public interest is served.* – *The Government of Ontario, through the Ministry of Energy, sets the overall policy for the energy sector. It does this mainly through laws and regulations.* – *The OEB regulates Ontario's energy sector. We ensure that natural gas and electricity companies follow the rules. As an independent government agency, our goal is to promote a sustainable, reliable energy sector that helps consumers get value from their natural gas and electricity services.* In the past decade, the independence of the OEB in relation to Hydro One and OPG has been accepted by the Auditor General of Ontario. – It is important to note that both Hydro One and OPG are classified as Government Business Enterprises and report under IFRS in their consolidated financial statements, are consolidated by the modified equity method into the province's books, are regulated by the OEB, and their respective regulatory assets and liabilities are reported in the province's books.	Met
(b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products.	Prior to the FHP Act, the rates approved by the OEB were designed to recover the IESO's operating costs and the commodity price of electricity. The effect of the FHP Act is to defer the collection of a total estimated amount of $20 billion (plus interest) of commodity price of electricity over an estimated period of 30 years. That is, it still provides for recovery of costs incurred just over a longer period of time. As mentioned above, a regulated utility subject to a deferred recovery plan is required to consider whether it continues to meet the criteria ASC 980-10-15-2 (b). This criterion requires a cause-and-effect relationship between a reporting entity's costs and its revenue. In addition, the timing of cost recovery and the related frequency of ratemaking is important. A reporting entity should consider its rate case experience, including the design of its rates and timing of	Met

Criteria	Comment	Evaluation
	recovery, when determining whether this criterion is met. These factors are analyzed below. *Frequency of rate case* – Currently, the IESO is subject to OEB's regular reviews to set the rates to recover its operating costs and the commodity price of electricity. – Although the recovery of commodity price of electricity has been frozen at the approved rate on May 1, 2017 plus inflation for the first four years, the IESO has been granted a right to recover after May 1, 2021, the IESO deferral recorded in the variance account during that four-year period. Based on Sections 24 and 25 of the FHP Act: - *A recording of the balance in the variance account is determinative of the balance, as of the time of the recording. (We note that this confirms that the costs will be considered to have been prudently incurred and there will be no additional prudence review by the OEB.)* - *Right to recover the balance recorded in the variance account.* - *Obligation on the part of the OEB to dispose the variance account in accordance with the regulation.* – Subsequent to May 1, 2021, the OEB will be required to determine and set rates payable by specified consumers to allow for IESO to recover the balance recorded in the variance account. This legislation compels the OEB and they have no discretion but to do so. - *The Board shall, from time to time, determine and set rates payable by specified consumers to allow for IESO to recover the balance recorded in the variance account.* - *Despite anything to the contrary in the OEB Act, the Board may exercise any of its responsibilities under this Act without a hearing.* *Rates are designed to recover incurred costs* – There is a cause-and-effect relationship between the purchase energy costs and revenue, as IESO will be allowed to recover the costs incurred. - *A recording of the balance in the variance account is determinative of the balance, as of the time of the recording. (As mentioned above, there will be no additional prudence review by the OEB.)*	

Criteria	Comment	Evaluation
	- *Right to recover the balance recorded in the variance account.* - *Obligation on the part of the OEB to dispose the variance account in accordance with the regulation.* *Periods of alternative ratemaking (e.g., rate freezes)* Evaluation of the second criterion requires additional judgment if the regulated utility is subject to any form of ratemaking that introduces uncertainty about the cause-and-effect relationship between costs and rates. A rate freeze period is understood in the industry as a fixed rate that is charged to customers during a period of time (more than two years) and the utilities are exposed to increases in operating and energy costs with no ability to recover the variances. This is not the case as IESO has been granted the right to recover fully the IESO deferral recorded in the variance account, including that incurred in the first four-year period. – *The Board shall, from time to time and in accordance with the regulations, determine and set rates payable by specified consumers to <u>allow for the IESO to recover the balance recorded in the variance account</u>. (Emphasis added)* *Costs uncertainty* As the IESO has been granted the right to fully recover the IESO deferral recorded in the variance account and the OEB is required to determine and set rates to allow for this recovery, there is no uncertainty about the recovery of the costs. *Disallowances of costs* As the IESO has been granted by legislation the right to fully recover the IESO deferral recorded in the variance account and section 24(2) of the FHP Act states that a recording of amounts in the variance account is determinative of the balance as of the time of recording, there is no risk of the potential disallowance of regulatory asset. Based on the analysis of the above factors, there is a direct cause-and-effect relationship between IESO's costs and their future collection.	
(c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume	The remaining criterion is whether limitations, including considering demand levels at the approved rates, on the extent of recovery of the regulatory asset could prevent the IESO from recognizing a regulatory asset for the entire balance in the recovery right granted to the IESO.	Met

Criteria	Comment	Evaluation
that rates set at levels that will recover the entity's costs <u>can be charged to and collected from customers.</u> This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.	The FHP Act notes that: – *Effective May 1, 2017, the IESO has a right to recover the balance in the variance account.* - *The Board shall, from time to time and in accordance with the regulations, determine and set rates payable by specified customers to allow for the IESO to recover the balance recorded in the variance account.* - *IESO shall not be entitled to collect the variance account from specified consumers before May 1, 2021.* Although the process, especially the timing of the recovery of the regulatory asset, has not been established yet by the OEB, the wording and intent of the legislation is clear that it is intended by law to be recoverable (over an estimated period of 30 years). Based on the 2017 LTEP issued by the Ministry of Energy, the demand of electricity is forecast to be relatively steady over the planning period (2017-2035). In the long-term, the IESO projects an increase in overall demand as electrification of the economy increases. Given the nature and extent of customer demand for the power generated and distributed in Ontario, both at this time and projected in the future, it is reasonable to conclude that there will be sufficient demand to recover the regulatory asset from specified customers. As with the other criteria, this will need to be continuously evaluated throughout the recovery period to ensure the IESO may continue to apply the guidance in ASC 980. Furthermore, it is expected that the IESO deferral recorded in the variance account (the regulatory asset) will be transferred to the Trust on a regular basis and cash collected at the time of a transfer. As a result, the regulatory asset will be recovered over the period of time during which there are transfers to the Trust. As discussed in issue #3, the Trust does not have any recourse against IESO if amounts recovered by the Trust from specified consumers are insufficient for any reason, including for example due to insufficient demand for electricity. – *The IESO deferral recorded in the variance account for the first period to December 21, 2017 amounted to approximately $1,179,000,000 and was transferred to and paid for by the Trust on that date.*	

Thus, we are of the view that the arrangement is within the scope of Topic 980.

Criteria for the recognition of regulatory assets

Subtopic 980-340-25 provides that an entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

– It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

– Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

Each of the criteria are discussed below:

Criteria	Comment	Evaluation
(a) It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. (b) Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost <u>rather than to provide for expected levels of similar future costs.</u> *(Emphasis added)* If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.	The FHP Act and Regulations note that, – *A recording of the balance in the variance account is determinative of the balance as of the time of the recording.* – *The carrying costs paid to the financing entity for costs incurred during the period from June 1, 2017 to July 31, 2021 shall be recorded in the variance account.* – *Effective May 1, 2017, the IESO has the right, exercisable in accordance with this Act and the regulations, to recover the balance recorded in the variance account from specified consumers.* – *The Board shall, from time to time and in accordance with the regulations, determine and set rates payable by specified consumers to allow for IESO to recover the balance recorded in the variance account.* – *The IESO shall not be entitled to collect all or part of the balance recorded in the variance account from specified consumers before May 1, 2021.* The FHP Act provides that the Board shall, – *Determine the rates charged for the specified consumers (i.e. regulated rate consumers and other specified consumers).* – *Ensure that adjustments, payments, set-offs and credits required or permitted (in the variance account) are made in accordance with the regulations.* – *Determine and set rates payable by specified consumers to allow for the IESO to recover the balance recorded in the variance account*.	Met

Criteria	Comment	Evaluation
	Based on the FHP Act, the IESO has the right to recover the balance recorded in the variance account, including the carrying costs, and the OEB is obligated by legislation to set rates that enable recovery of the specific costs recorded in the variance account. As a result, it is clear that the rate making by the OEB will enable IESO to recover the amount previously incurred rather than to provide for expected levels of similar future costs.	

Management conclusion

IESO management has concluded that the IESO can recognize a regulatory asset related to the variance account created by the FHP Act based on the foregoing analysis.

The variance account created by the FHP Act is subject to rate regulation by the OEB and the variance account has been established with the right to collect funds against the variance amount in the future. Further, the FHP Act requires the OEB to set rates that will ensure recovery of the variance account. In these circumstances, the IESO is able to establish that a regulatory asset exists. The IESO financial statements are prepared in accordance with Canadian Public Sector Accounting Standards. Although PSAS does not provide specific guidance on rate regulated accounting, it does under PS 1150 *Generally Accepted Accounting Principles*, allow for guidance to be followed from other accounting frameworks. IESO has applied guidance from United States Generally Accepted Accounting Principles (US GAAP) Topic 980, *Regulated Operations* in its accounting policies.

Our conclusion

We have considered the foregoing analysis and management's conclusion. We concur with management that the variance account created by the FHP Act meets the criteria for the recognition of a regulatory asset stated in ASC 980-340-25-1; as noted above, IESO has adopted the provisions of ASC 980 in accounting for assets and liabilities subject to regulated operations. Furthermore, we have also considered the criteria stated in ASC 980-10-15-2 and concur with management that IESO should continue to use the guidance for regulated operations of Topic 980.

Issue #2: Is the Fair Hydro Trust established by Ontario Power Generation Inc. (the "Trust") controlled by the IESO according to the guidance issued under PSAS 1300 *Government Reporting Entity* and therefore subject to consolidation by IESO?

Background for Issue #2

The facts, circumstances, and assumptions relevant to the specific transactions as provided to us by the management of the Company (responsible party), in addition to those described in the background for Issue #1 are as follows:

1. Up until the implementation of the FHP Act, the IESO had the right to collect the commodity cost of electricity (including the global adjustment) monthly from ratepayers through provisions in the Electricity Act and the OEB Act. The FHP Act requires that collection of a certain portion of the monthly commodity cost of electricity be deferred and the reduced collection compared to what would have been collected without the FHP Act recorded in a variance account along with other amounts (for collection in the future from specified consumers). The FHP Act also establishes the basis for structured financing/securitization of the future right to recover the deferred commodity cost of electricity from specified consumers.
2. OPG has been appointed as Financial Services Manager under the FHP Act.
3. In connection with the FHP Act, the *Fair Hydro Trust* has been established as a financing vehicle by OPG (in its capacity as Financial Services Manager) for the purpose of financing the transfer by IESO of a specified portion of a regulatory asset to the Trust, which trust thereby acquires a corresponding investment interest in the investment asset. The Trust will acquire a specified portion of the regulatory asset from the IESO for the principal amount (i.e., the carrying value) of the specified portion of the regulatory asset being transferred in an amount equal to the amount of the specified portion (Section 26 (2) of FHP Act).
4. The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets, and subordinated financing from OPG (which we understand will be funded mostly from equity injections from the Province of Ontario).
5. The Issuer Trustee of the Trust has appointed OPG as the Manager of the Trust, which gives OPG the responsibility of directing all of the activities of the Trust, through a services agreement as permitted by the Trust's constating documents, the FHP Act and the Electricity Act.
6. We understand that FHP 2017 Inc., a wholly-owned subsidiary of OPG, owns 99.9999% of the units of the Trust with the remaining units owned by the Issuer Trustee.
7. Relevant sections from the FHP Act

   Section 22 *Financing entities*

   (1) The Financial Services Manager shall ensure that funding obligations incurred for the purposes of this Act are incurred in a manner that is consistent with the applicable Financing Plan.

   (2) In accordance with the Financing Plan, the Financial Services Manager may establish or cause to be established one or more financing entities that may incur funding obligations.

8. Relevant sections from the Management Agreement

Section 3.1 *Appointment and Authority of the Manager*

The Issuer hereby appoints Ontario Power Generation Inc. as the Manager to act as its agent to provide services and perform duties for and on behalf of and for the account of the Issuer, as hereinafter provided, in connection with the activities of the Issuer relating to:

(a) the acquisition, administration and possible transfer of the Issuer Investment Interest on behalf of the Issuer in accordance with the Act;

(b) acting as custodian of the Investment Interest Records;

(c) the entering into and execution and delivery on behalf of the Issuer of any Program Agreements;

(d) the incurrence of Issuer Funding Obligations, and repayment thereof, to fund the acquisition of the Issuer Investment Interest;

(e) the negotiation, execution and delivering or filing on behalf of the Issuer of any Offering Materials;

(f) the implementation and administration of the provisions of the Program Agreements to which the Issuer or the Manager on its behalf is a party;

(g) the acquisition, administration and sale of investments that may from time to time be made by the Issuer; and

(h) all activities as may be reasonably incidental to the foregoing or necessary in connection with the performance by the Issuer of its obligations under the Program Agreements, the Act and the Regulations.

The Manager accepts such appointment and agrees to act in such capacity and to provide or cause to be provided the services and to perform the duties set forth in this Agreement on and subject to the terms and conditions in this Agreement. The Issuer hereby grants to the Manager the power and authority to act in the name of and on behalf of the Issuer, and to execute and deliver all documents, agreements and instruments in the name and on behalf of the Issuer, for the sole purpose of providing the services and performing the duties to be provided and performed by the Manager pursuant to this Agreement. The Manager shall provide all the services and perform all the duties contemplated under this Agreement, including its duties as Financial Services Manager under the Act, in Ontario, Canada.

9. Relevant sections from the Fair Hydro Trust's Declaration of Trust

Section 1.1 Definitions

"Issuer Trustee" means Computershare Trust Company of Canada and any successor thereto appointed pursuant to Article 6.

Section 2.1 Purpose and Activities of the Trust

The purpose of the Trust is to establish and carry on activities for the exclusive benefit of the Unitholders and to distribute the Trust Property upon termination of those activities by the Trust in accordance with Article 11. The Trust is permitted to engage in any activity, undertaking, transaction or event authorized or permitted by the FHP Act (the "Trust Activities")

Section 2.2 Limitation on certain activities

Notwithstanding any other provision of this Declaration of Trust or the Management Agreement, at any time that any Funding Obligations remain outstanding, the consent of the Indenture Trustee shall be required for the Trust to:

(a) take any action to wind-up or dissolve the Trust; or

(b) institute any voluntary proceedings to be adjudicated bankrupt or insolvent, or consent to the institution of any bankruptcy or insolvency proceedings against it, or file a petition seeking or consent to any assignment, petition, application or proceeding under any applicable bankruptcy or insolvency law, or consent to the appointment of a receiver, liquidator, assignee, trustee or other similar official of the Trust or a substantial part of its property, or make any assignment for the benefit of creditors, or admit in writing its inability to pay its debts generally as they become due, or take any similar action in respect of the Trust.

Section 2.4 Nature of the Trust

The beneficial interest and rights generally of the Unitholders in the Trust shall be limited to the right to participate in distributions when and as declared by the Issuer Trustee and distributions upon the termination of the Trust.

Section 2.5 Rights of Unitholders

No Unitholder shall be entitled to call for any partition or division of the Trust Property or for a distribution of any particular asset forming part of the Trust Property or of any particular monies or funds received by the Issuer Trustee. The legal ownership of the Trust Property and the right to conduct the activities of the Trust are vested exclusively in the Issuer Trustee, and no Unitholder has or is deemed to have any right of ownership in any of the Trust Property, except as specifically provided herein.

Section 3.7 Liability of Unitholders

No Unitholder of the Trust, in its capacity as such, will incur or be subject to any liability, direct or indirect, absolute or contingent, in contract or in tort or of any other kind, to any Person in connection with: … (ii) the obligations, liabilities, activities or affairs of the Trust …

Section 5.1 Rights and Powers of Issuer Trustee

Subject to the specific restrictions and limitations set forth in this Declaration of Trust and notwithstanding the provisions of the Trustee Act (Ontario) or any other similar legislation in any jurisdiction, the Issuer Trustee will have, without the necessity of authorization by, and free from any power or control on the part of, the Unitholders, <u>full, exclusive and absolute power, control and authority over the Trust Property and the Trust Activities</u> to the same extent as if the Issuer Trustee were the sole and absolute owner thereof in its own right including, without limitation, such power, control and authority to do all such acts and things as in its sole judgment and discretion are necessary, incidental or desirable for carrying on the Trust Activities in accordance with the Program Agreements with such powers of delegation as may be permitted by this Declaration of Trust, including the right, power and authority to amend this Declaration of Trust subject to and in accordance with the terms hereof and to appoint, employ or contract with any Person as the Issuer Trustee may deem necessary, appropriate or desirable for the transaction of the Trust Activities, including for the administration of the Trust. (Emphasis added)

Section 5.6 Power to Borrow Money and Issue Funding Obligations

In accordance with and subject to the terms of the Program Agreements, the Issuer Trustee will have the power to:

(a) borrow or in any other manner raise money and to evidence the same by the issuance of Funding Obligations, by private placement, public offering or otherwise.

Section 5.15 Power to Contract

In accordance with and subject to the terms of the Program Agreements, the Issuer Trustee will have the power to appoint, employ or contract with any Person as the Issuer Trustee may deem necessary or desirable for the transaction of the Trust Activities and may transfer assets to such Person and, save and except for such matters as are listed in Section 2.2, delegate to such Person any or all of the discretionary powers given to the Issuer Trustee with respect to the management of the Trust Property.

Section 6.2 Removal of Issuer Trustee

The Issuer Trustee may be removed from its office under this Declaration of Trust by the Unitholders, at any time by notice in writing delivered to the Issuer Trustee not less than 90 days prior to the date that such removal is to take effect.

Section 6.4 Appointment of New Issuer Trustee

If, pursuant to this Article 6, the Issuer Trustee resigns or a vacancy occurs in the office of the Issuer Trustee for any reason, the Unitholders may, subject to the satisfaction of the Rating Agency Condition, by instrument in writing appoint a Trust Company, which has risk-based capital of at least $50,000,000 or, in the case of an entity that is not subject to risk-based capital adequacy requirements, has a combined capital and surplus of at least $50,000,000, in order to replace the Issuer Trustee.

Section 9.3 Quorum and Voting

A quorum for any meeting of the Unitholders will be persons present being Unitholders or representing by proxy Unitholders who hold in the aggregate a majority of the total number of outstanding Units. Unitholders may attend and vote at all meetings of the Unitholders either in person or by proxy. Each Unit will be entitled to one vote at all meetings of the Unitholders. Any action to be taken by the Unitholders will, except as otherwise required by this Declaration of Trust, or by law, be authorized when approved by a majority of the votes cast at a meeting of the Unitholders. The chairman of any such meeting will not have a second or casting vote.

Section 12.1 Termination of the Trust

(a) The Trust will continue in full force and effect for a period of twelve months from the date hereof and thereafter for so long as any Funding Obligations remain outstanding and until the Trust has satisfied all of its obligations under the Program Agreements or otherwise for the purposes of carrying on the Trust Activities. Notwithstanding the foregoing, the Issuer Trustee may, with the unanimous approval of Unitholders, wind-up the affairs of the Trust and terminate the Trust and distribute the Trust Property then remaining to the Unitholders in proportion to the number of Units held by each Unitholder no later than the date that is one day prior to the 21st anniversary of the death of the last surviving lineal descendent of Queen Elizabeth, II of England living at the date this declaration is made.

(b) Subject to Section 12.1(a), the Issuer Trustee may, with the unanimous approval of the Unitholders, wind up the affairs of the Trust and terminate the Trust.

8. Relevant section from the Trust Indenture

   Section 8.10 Termination by Indenture Trustee of Manager and Servicer

   Upon the occurrence and during the continuance of an Event of Default, the Indenture Trustee shall have the right to (and, upon receipt of an Extraordinary Resolution to that effect, shall) terminate the appointment of the then existing Manager under the Management Agreement and/or the Servicer under the Master Transfer and Servicing Agreement, and appoint new Persons under such agreements in accordance with such direction, provided that the Issuer shall have the right to reinstate any appointee under such agreements at such time as the Event of Default is no longer continuing. (Emphasis added)

Relevant Accounting Guidance for Issue #2

Relevant sections of PS 1300 *Government Reporting Entity*:

PSAS refers to government or government organizations. For the purpose of this analysis, the PSAS guidance below relating to *government* or *government organizations* should be read and understood as being the IESO. (Emphasis added below)

- The government reporting entity should comprise government components and those organizations that are controlled by the government. [PS 1300.07]
- Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. [PS 1300.08].
- Whether a government controls an organization is a question of fact that must be determined by reference to the definition of control established in paragraph PS 1300.08 and the particular circumstances of each case. The determination of the fact that control exists will require the application of professional judgment. Government achieves its objectives through a wide range of organizations which individually will fall somewhere along a continuum. At one end of the continuum, it will be clear that an organization does not have the power to act independently and is controlled by the government. At the other end, the organization will have the power to act independently and, while government will have a level of influence on the organization, it will be clear that it does not have control. Along the continuum, consideration needs to be given to the nature of the relationship between the government and the organization in order to determine whether control exists. This Section provides guidance intended to assist in this assessment. [PS 1300.10]
- In applying this guidance, it is necessary to determine the substance of the relationship between the government and the organization. The true nature of certain relationships may not be completely reflected by their legal form. All relevant aspects and implications of the relationship would be considered in determining whether or not the government controls the organization. Where various aspects of the relationship are designed, in effect, to achieve an overall objective, they would be viewed as a whole. [PS 1300.11]
- Financial and operating policies are principles and practices that determine how an organization conducts its activities. The ability to govern these policies is an important element of government control because it establishes the fundamental basis for the conduct of the organization's operations and the achievement of its mission and mandate. [PS 1300.13]
- There are a variety of ways to govern the financial and operating policies of an organization. For example:
  (a) a government may establish an organization's fundamental purpose and eliminate or significantly limit the ability of the organization to make future decisions by predetermining the financial and operating policies of the organization;

(b) a government may direct the financial and operating policies of an organization on an ongoing basis; or

(c) a government may veto, overrule or modify the financial and operating policies established by an organization. [PS 1300.14]

– A government does not need to manage an organization's activities on a day-to-day basis to control the organization. It is the government's existing authority to determine the policies governing those activities that is important. [PS 1300.15]

– For the purposes of this Section, it is assumed that where the government has the power to govern the financial and operating policies of an organization, it expects to derive a financial or non-financial benefit. The government may also be exposed to the risk of loss. [PS 1300.16]

Analysis of Issue #2: Is the Fair Hydro Trust established by OPG (the "Trust") controlled by the IESO, according to the guidance issued under PSAS 1300 *Government Reporting Entity* and, therefore, subject to consolidation by IESO?

As part of the assessment of the accounting for the regulatory asset, an entity should consider whether the transfer of the regulatory asset discussed in issue #1 to the Trust represents a transfer to a consolidated subsidiary. Therefore, the first step in determining whether sale accounting has occurred is to determine if purchasing entity (the "transferee") is required to be consolidated by the transferor. This section address that issue.

Under PSAS, IESO is required to consolidate all entities that are considered to be part of its reporting entity, applying the guidance provided in *Section PS 1300 Government Reporting Entity.* Under PS 1300, IESO must consolidate all entities it "controls".

In order to determine whether or not the Trust should be consolidated by IESO, it must be determined whether or not the IESO exercises control as a consequence of its power to govern the financial and operating policies of the Trust, resulting in expected benefits to the IESO or the risk of loss from the activities of the Trust.

Under PS 1300.08, control is defined as "the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities". PS 1300.17 indicates that "whether a government controls an organization is a question of fact that requires the application of professional judgment based on the definition of control in this Section and the substance of the relationship in each case." Therefore, the determination of whether IESO is required to consolidate the Trust is based on an assessment of whether IESO is considered to control the Trust based on the indicators of control set out in PS 1300. The assessment of the IESO's control of the Trust is made based on the terms and conditions of the related arrangements in their entity, including the FHP Act and the MTSA Agreement, and the facts and nature of the relationship between the IESO and the Trust and is based on facts and assumptions provided by the IESO. PS 1300.18 and .19 set out 11 potential indicators of control. Several of these indicators have been categorized as more persuasive of a finding of control (see the first four indicators in the table below). For each indicator that applies, the degree of government influence would determine its importance as evidence of control. Finally, the indicators are considered both collectively and individually.

A detailed analysis of the 11 Indicators of control is provided in the following table.

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
Primary (more persuasive) indicators (PS 1300.18):		
1. Does IESO have the power to unilaterally appoint or remove a majority of the members of the governing body of the organization?	At the request of OPG, the Issuer Trustee (Computershare) has established the *Fair Hydro Trust* to purchase the regulatory asset transferred from IESO, related financing and administrative activities, including recovery of amounts from specified consumers. The Issuer Trustee is the governing body of the Trust. However OPG, as the majority Unitholder, has the voting power to unilaterally appoint or remove the Issuer Trustee. Furthermore, the Issuer Trustee has the right to delegate all of the discretionary powers given to the Issuer Trustee with respect to the management of the Trust Property, except for the obligations listed in Section 2.2 of the MTSA Agreement related to the satisfaction of the conditions precedent for each transfer of the regulatory asset, which are considered administrative tasks or protective rights. In that respect, the Issuer Trustee has appointed OPG as the Manager, which gives OPG the responsibility of directing all of the activities of the Trust, through a services agreement as permitted by the FHP Act, the Electricity Act and the Declaration of Trust. The Management Agreement states: – *The Issuer appointed OPG as the Manager to act as its agent to provide services and perform duties for and on behalf of and for the account of the Issuer, as hereinafter provided, in connection with the activities of the Issuer…* The FHP Act states: – *OPG is appointed as the Financial Services Manager for the purposes of this Act. (Section 18)* – *The Financial Services Manager shall perform the duties assigned to it under this Act and may administer the investment asset on behalf of the investment interest owners. (Section 19 (1))* Section 53.1 Objects of OPG of the Electricity Act has been amended as follows: – *In addition to the objects mentioned in subsection (1), the objects of OPG include exercising the powers and rights and performing the duties and obligations assigned to it under the FHP Act, 2017 and engaging in activities to facilitate the implementation of that Act, including entering into contracts and undertakings on behalf of financing entities and performing other services on behalf of financing entities, subject to the right to be paid by the financing entities for those services. (Section 53.1 (1.1))*	No

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
	– *OPG may create or invest in one or more subsidiaries, trusts, partnerships or special purpose entities in order to more efficiently conduct its activities or achieve its objects. (Section 53.1 (1.2))* The Declaration of Trust notes that: – *The Issuer Trustee will have, without the necessity of authorization by, and free from any power or control on the part of, the Unitholders, full, exclusive and absolute power, control and authority over the Trust Property and the Trust Activities to the same extent as if the Issuer Trustee were the sole and absolute owner thereof in its own right… (Section 5.1)* – *The Issuer Trustee may be removed from its office under this Declaration of Trust by the Unitholders, at any time… (Section 6.2)* – *… the Unitholders may, subject to the satisfaction of the Rating Agency Condition, by instrument in writing appoint a Trust Company… in order to replace the Issuer Trustee… (Section 6.4)* – *Any action to be taken by the Unitholders will, except as otherwise required by this Declaration of Trust, or by law, be authorized when approved by a majority of the votes cast at a meeting of the Unitholders. (Section 9.3)* The IESO does not have any rights in respect to the appointment or replacement of the Issuer Trustee of the Trust.	
2. Does IESO have ongoing access to the assets of the organization, have the ability to direct the ongoing use of those assets, or have ongoing responsibility for losses?	IESO does not have ongoing access to the assets of the organization. Based on Section 27 of the FHP Act, once the regulatory asset is transferred to the Trust, the asset is considered “absolutely” assigned, conveyed and disposed of. That is, Section 27 of the FHP Act notes: – *A transfer of a specified portion of the regulatory asset under section 26 constitutes a valid and enforceable absolute assignment, conveyance and sale of the corresponding investment interest to the transferee.* – *Without limiting subsection (1), any transfer agreement that states an intention of the parties for the IESO to dispose of a specified portion of the regulatory asset and to assign, convey or sell a corresponding investment interest shall be treated for all purposes as an absolute assignment, conveyance, disposition and sale of the IESO’s right to recover the corresponding amount in the variance account and not merely as a security interest.*	No

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
	– *At the time a transfer of the regulatory asset is made under section 26, the transfer shall be deemed to have been and shall be perfected, vested, valid and binding as against the transferor and all other persons who have claims of any kind against the transferor.* Based on the FHP Act, *upon transfer of a specified portion of the regulatory asset under section 26 to a financing entity, the investment asset resulting from the transfer is immediately vested in the Trust, free and clear of any adverse claim.* (Section 28 (2)). IESO does not have the ability to direct the ongoing use of the Trust's assets. The Issuer Trustee is the governing body of the Trust, however OPG has the power to unilaterally appoint or remove the Issuer Trustee. In accordance with the Management Agreement, OPG has been appointed the Manager of the Trust. Based on the Management Agreement of the Trust, OPG as the Manager, has been given the responsibility to direct all of the activities of the Trust. The main Unitholder (99.9999%) of the Trust is a wholly-owned subsidiary of OPG. IESO also does not have ongoing responsibility for losses incurred by the Trust. IESO does not bear the credit risk related to the collection of the investment asset; it is borne by the Unitholders of the Trust up to the amount of their investments in the Trust (total value of units, subordinated notes and junior subordinated notes) and then by the other lenders (i.e. the senior noteholders). IESO does not bear payment risk related to usage: that is, if the ratepayer base were to shrink, the exposure to a decline in collections is solely of that of the Unitholders of the Trust up to the amount of their investments in the Trust and then by the other lenders. IESO has no responsibility to compensate the Unitholders or the lenders for any loss it incurs resulting from the failure of specified customers to pay their obligations as due, whether that failure arises from credit risk or usage risk. In conclusion, upon transfer of the regulatory asset to the Trust, IESO will no longer have access/ability to direct the regulatory asset nor will it have ongoing responsibility for losses.	

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
3. Does IESO hold the majority of the voting shares or a "golden share" that confers the power to govern the financial and operating policies of the organization?	In accordance with section 5.1 of the Declaration of Trust, the Issuer Trustee has without the necessity of authorization by, and free from any power or control on the part of, the Unitholders, full, exclusive and absolute power, control and authority over the Trust Property and the Trust Activities to the same extent as if the Issuer Trustee were the sole and absolute owner thereof in its own right. We understand that FHP2017 Inc., a wholly-owned subsidiary of OPG, owns 99.9999% of the units of the Trust with the remaining units owned by the Issuer Trustee. IESO does not have any ownership in the Trust and does not have the power to govern the financial and operating policies of the Trust.	No
4. Does IESO have the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations?	The Declaration of Trust provides for: – *The consent of the Indenture Trustee shall be required for the Trust to take any action to wind-up or dissolve the Trust. (Section 12.1(a))* – *Subject to Section 12.1(a), the Issuer Trustee may, with the unanimous approval of the Unitholders, wind up the affairs of the Trust and terminate the Trust. (Section 12.1(b))* IESO does not have the power to dissolve the Trust.	No

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
Other indicators that may provide evidence of control (PS 1300.18):		
5. Can IESO provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members?	As mentioned in indicator 1 above, OPG has the power to unilaterally appoint or remove the Issuer Trustee of the Trust. IESO does not provide any input in the appointment of the members of the governing body of the Trust.	No
6. Can IESO appoint or remove the CEO or other key personnel?	As mentioned under indicator 1 above, OPG has the power to unilaterally appoint or remove the Issuer Trustee of the Trust. As mentioned under indicator 2 above, OPG has been appointed as the Manager of the Trust and has been given the responsibility to direct all of the activities of the Trust. IESO does not have any rights to appoint or remove the Issuer Trustee or the Manager.	No
7. Can IESO establish or amend the mission or mandate of the organization?	The Trust has been established by the Issuer Trustee at the request of OPG (in its capacity as Financial Services Manager) and the mandate of the Trust is based on the FHP Act.	No
8. Does IESO have the right to approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis?	The FHP Act states: – *OPG is appointed as the Financial Services Manager for the purposes of this Act.* – *The Financial Services Manager shall prepare a written plan entitled the Financing Plan to be used by the Financial Services Manager to evaluate whether potential funding obligations should be incurred for the purposes of acquiring and financing an investment asset in accordance with this Act or for the purposes of refinancing.* OPG is the Financial Services Manager, not IESO. IESO has no ability to be involved in the preparation or approval of the business plans or budget of the Trust.	No

INDICATOR OF CONTROLS	EVIDENCE OF CONTROL	CONTROL EXIST?
9. Can IESO establish borrowing or investment limits or restrict the organization's investments?	As the Financial Services Manager and the Manager of the Trust, OPG will establish the borrowing limits and the financing entities. Section 22 (1) and (2) of the FHP Act states: – *The Financial Services Manager shall ensure that funding obligations incurred for the purposes of this Act are incurred in a manner that is consistent with the applicable Financing Plan.* – *The Financial Services Manager may establish or cause to be established one or more financing entities that may incur funding obligations.* Section 5.6 of the Declaration of Trust states: – *The Issuer Trustee will have the power to borrow or in any other manner raise money…* Section 3.1 of the Management Agreement states: – *The Issuer hereby appoints OPG as the Manager… to provide services… in connection with the activities of the Issuer relating to the incurrence of Issuer Funding Obligations, and repayment thereof, to fund the acquisition of the Issuer Investment Interest…* OPG, not IESO, is responsible for ensuring that the required borrowings and financing entities of the Trust meet the above conditions.	No
10. Can IESO restrict the revenue-generating capacity of the organization, notably the sources of revenue?	The Trust's source of revenue is the yield earned on its investment. That yield is influenced ultimately by the ratepayers who directly influence the payback period of the cash flows underlying the regulatory asset. IESO has no ability to restrict this source of revenue.	No
11. Can IESO establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining or deployment of resources?	As mentioned above, the FHP Act and the Management Agreement related to the Trust granted OPG the power to establish or amend the policies of the Trust and the ability to appoint and remove the Issuer Trustee.	No

Management conclusion

IESO management concluded that the Trust is not controlled by the IESO and therefore is not subject to consolidation by the IESO.

Based on the foregoing analysis of the 11 indicators of control as defined in Section PS 1300 *Government Reporting Entity*, when considered both individually and collectively, there is no evidence of control by IESO in respect of the Trust. The IESO does not have the power to govern the Trust, nor does it have ongoing access to the Trust's assets. The IESO does not have any voting units or future rights to the Trust nor the power to dissolve the Trust. Without control, the Trust should not be subject to consolidation within the IESO financial statements.

Our conclusion

We have considered the foregoing analysis and management's conclusion. We concur that based on the FHP Act and the Declaration of Trust of the Fair Hydro Trust, none of the four primary (more persuasive) indicators of control are considered to be met, and none of the seven other indicators of control are considered to be met. Accordingly, we concur with IESO management that IESO does not control the Trust under the FHP Act and therefore should not consolidate the Trust.

Issue #3: What is the accounting treatment for the transfer of the regulatory asset by the IESO to the Trust? More specifically, does the transfer qualify as a derecognition event for accounting by the IESO?

Background for Issue #3

The facts, circumstances, and assumptions relevant to the specific transactions as provided to us by the management of the Company (responsible party), in addition to those described in the background for issues #1 and 2 are as follows:

1. Fair Hydro Trust: Computershare Trust Company of Canada is the Issuer Trustee, OPG is the Financial Services Manager and Manager, and IESO is the Servicer.
2. The total IESO deferral for the period from May 1, 2017 to April 30, 2047 is estimated at $20 billion plus interest and will be recorded by the IESO in a variance account recognized as a regulatory asset. The IESO deferral will include the carrying charges paid to the Trust pursuant to the Regulations for the period from June 1, 2017 to July 31, 2021.
3. The IESO does not currently have the financial capability to finance the regulatory asset and will transfer a specified portion of the regulatory asset to the Trust from time to time.
4. It is expected that the regulatory asset will be transferred to the Trust on a regular basis and the proceeds for each transfer will be received by IESO at the time of the transfer.
5. The IESO deferral recorded in the variance account for the first period to December 21, 2017 amounted to approx. $1,179,000,000 and was transferred to and paid for by the Trust on that date.
6. The IESO has obtained a written legal opinion from Stikeman Elliott LLP as to the validity and enforceability of the transfer of the investment interest in the regulatory asset.
7. Based on an assessment of control performed under the issue #2, IESO should not consolidate the Trust. We understand that an assessment of control under IFRS has been performed by OPG and they have concluded that the Trust will be consolidated by OPG; we note that the financial reporting framework used by OPG in preparing its financial statements for consolidation into the Province's books is IFRS.[2]
8. Relevant sections from the FHP Act

Section 15 Determination of clean energy adjustment

Financial Services Manager to determine

(1) The Financial Services Manager shall determine the CEA payable by all specified consumers in respect of each month in a reference period by taking the following steps:

1. Calculate the sum of the following:
    i. The estimated finance amount in respect of the reference period.
    ii. The true up amount in respect of the reference period.
2. Divide the sum calculated under paragraph 1 by the number of months in the reference period.

[2] Our views that IESO does not control OPG Trust, and thus, should not consolidate OPG Trust are not dependent upon the conclusions reached by the OPG as to whether OPG should consolidate OPG Trust. It is a helpful fact, but not a necessary fact for our conclusion regarding IESO's accounting relationship to OPG Trust.

Regulations re true up amount

(2) The Lieutenant Governor in Council shall, in making regulations with respect to the determination of the true up amount, have regard to the following principles:

2. The method for determining the true up amount should take into account historical and reasonably foreseeable,

    i. differences between the estimated and actual finance amount for the applicable reference period,

    ii. differences between amounts invoiced and amounts collected due to various factors, including applicable taxes, consumer defaults and delays, billing lags and write-offs, and

    iii. variations in billings due to variations in electricity consumption.

Section 16 IESO to receive amounts

(1) The IESO shall, as agent of the investment interest owners, receive amounts in respect of the clean energy adjustment paid to it from electricity vendors in accordance with the market rules made under section 32 of the Electricity Act, 1998 or the regulations.

(3) All amounts received by the IESO in respect of the clean energy adjustment shall, until remitted to or for the benefit of the investment interest owner, be held in trust by the IESO for the investment interest owners.

(4) The IESO shall remit amounts received by it in respect of the clean energy adjustment, inclusive of interest earned on the amounts referred to in subsection (1), to or for the benefit of the investment interest owners in accordance with the regulations.

Section 26 Transfer of regulatory asset

(1) The IESO may from time to time, in accordance with this Act and the regulations, transfer a specified portion of the regulatory asset to a financing entity in accordance with this section.

(2) An agreement between the IESO and a financing entity in relation to the transfer of a specified portion of the regulatory asset shall provide for consideration of a payment by the financing entity to the IESO in an amount equal to the amount of the specified portion.

(3) Upon receipt by the IESO of the payment by the financing entity,

(a) the balance in the variance account shall be reduced by the amount of the payment;

(b) the regulatory asset shall be adjusted accordingly;

(c) the financing entity shall acquire a corresponding investment interest; and

(d) the IESO shall retain no further right, title or interest in the investment interest.

Section 27 Validity of transfer

(1) A transfer of a specified portion of the regulatory asset under section 26 constitutes a valid and enforceable absolute assignment, conveyance and sale of the corresponding investment interest to the transferee.

(2) Without limiting subsection (1), any transfer agreement that states an intention of the parties for IESO to dispose of a specified portion of the regulatory asset and to assign, convey or sell a corresponding investment interest shall be treated for all purposes as an absolute assignment, conveyance, disposition and sale of IESO's right to recover the corresponding amount in the variance account and not merely as a security interest.

(3) At the time a transfer of the regulatory asset is made under section 26, the transfer shall be deemed to have been and shall be perfected, vested, valid and binding as against the transferor and all other persons who have claims of any kind against the transferor.

(4) Subsection (3) applies regardless of whether the persons who have claims have received notice of the transfer and the property rights and interests acquired by the transferee shall have priority over any liens in favour of those persons.

Section 29 Investment asset, irrevocable rights and interests

(1) The investment asset constitutes a current and irrevocable property right and interest consisting, collectively, of the following rights and interests of investment interest owners:

1. The right and interest to impose, invoice, collect, receive and recover the clean energy adjustment from specified consumers, including the right to determine the clean energy adjustment in accordance with this Act.
2. The right to receive, collect and recover the clean energy adjustment that is imposed, invoiced and recoverable under this Act, including any amounts in respect of the clean energy adjustment that are held by electricity vendors, IESO and other prescribed parties.
3. All rights and entitlements under such accounts as may be prescribed by regulation and all amounts on deposit in such accounts.
4. The right to enforce the duties and obligations under this Act of each electricity vendor to impose, attribute, charge and invoice for the clean energy adjustment.
5. The right to enforce the duties and obligations under this Act of each electricity vendor and the IESO to collect, receive and remit amounts received by it in respect of the clean energy adjustment, including all collections and the proceeds of any enforcement action undertaken by any electricity vendor to recover payment of the clean energy adjustment.
6. All rights of any kind related to any of the other property rights or interests that comprise the investment interest, including any rights to receive funding rebates.
7. All revenue, collections, claims, payments, money and proceeds of or derived from the rights described in paragraphs 1 to 6, regardless of whether it is invoiced, collected and maintained together with or commingled with other revenue, collections, claims, payments, money and proceeds.

Section 30 Transfer of investment interest

(2) An investment interest owner may transfer all or a portion of an investment interest to any other investment interest owner, including by way of a transfer of a divided or an undivided interest, in accordance with the Financing Plan.

Section 31 Validity of transfer

(1) A transfer of an investment interest under this Act is a valid and enforceable sale and absolute transfer of the investment interest and confers upon the transferee a valid property right and interest in, to and under the applicable investment interest acquired in accordance with the terms of the transfer.

(2) Without limiting subsection (1), a transfer that by its terms is intended to constitute a sale or absolute transfer shall be treated for all purposes as an absolute transfer of an investment interest owner's right, title and interest in, to and under an investment interest, and not merely as a security interest, and upon such absolute transfer the transferor shall retain no right, title or interest in the investment interest subject to the transfer, including all rights to the investment interest arising after the transfer.

Section 32 Investment interest owner may grant security interest

(1) An investment interest owner may grant a security interest over all or a specified portion of its right, title and interest in, to and under the investment interest to or in favour of any person to secure a funding obligation.

(3) All provisions of the Personal Property Security Act shall apply to the investment asset and each investment interest on the basis that the investment asset and each investment interest is intangible personal property, except as otherwise provided for in this section, and any granting of a security interest by an investment interest owner to secure a funding obligation shall, subject to the terms of the funding obligation, give rise to a security interest in respect of which that Act applies and may be perfected by registering a financing statement under that Act on that basis.

9. Relevant sections from Regulation 429/04

Section 10.2 Determination of rate re IESO security

The IESO shall, in respect of each month, determine the rate payable by specified consumers in respect of the costs incurred by the IESO to fulfil its obligations, if any, under an agreement with a financing entity to provide security by dividing the costs it incurred in respect of the month for the security by the monthly total net volume of electricity consumed by specified consumers calculated under section 10.1.

10. Relevant sections from the Ontario Regulation 206/17

Section 1 (1) Definitions

"Financing entity expense" includes,

(a) fees, including fees charged by the Financial Services Manager, charges, costs, indemnities, reimbursements, other amounts incurred or committed to, by or on behalf of a financing entity as a result of an activity authorized or permitted under the Act, and

(b) any taxes on amounts mentioned in clause (a);

"Funding cost" means interest, commitment fees or other similar costs payable by or on behalf of a financing entity in respect of funding obligations, including a derivative payment.

Section 6 Determining true up amount

(3) The true up amount in respect of a reference period or a portion of the reference period shall be determined, as follows: $T = (A - B) + C$

where,

T = the true up amount in respect of the period of time,

A = the aggregate of the finance amounts in respect of all reference periods preceding the current reference period and, if the determination is being made at a point in time during the current reference period, in respect of the portion of the current reference period that precedes the point in time,

B = the aggregate of all amounts of the clean energy adjustment remitted to or for the benefit of the investment interest owners during all reference periods preceding the current reference period and, if the determination is being made at a point in time during the current reference period, in respect of the portion of the current reference period that precedes the point in time,

C = the amount representing reasonably foreseeable differences between the amounts to be invoiced in respect of the clean energy adjustment and the amounts to be remitted by the IESO to the investment interest owners in respect of the invoices due to various factors, including those mentioned in subparagraphs 2 ii and iii of subsection 15 (2) of the Act.

Section 9.1 IESO to pay, remit amounts re carrying costs of financing entity

During the period beginning on December 1, 2017 and ending on July 31, 2021, the IESO shall pay and remit to a financing entity any amounts charged to the IESO by the financing entity in respect of carrying costs of the financing entity during the period beginning on June 1, 2017 and ending on July 31, 2021. The IESO may grant security to a financing entity in order to secure its obligations to pay and remit present and future amounts due under this section.

11. Relevant sections from the Master Transfer and Servicing Agreement (the "MTSA Agreement") signed between IESO and the Trust

Section 1 (1) Definitions

"Collection Account" means an Eligible Deposit Account established by the Issuer for the purpose of receiving the Issuer Share of the Servicer CEA Receipts.

"Remittance Date" means, in respect of each Billing Period, the 18th Business Day following the last day of each Billing Period.

Section 3.4 Clean Energy Adjustments and Electricity Vendors

(a) The Servicer shall prior to receiving Servicer CEA Receipts, establish an Eligible Deposit Account (the "IESO Segregated Account") bearing a designation indicating that the funds deposited therein are held in trust for the benefit of the Issuer…

(e) As agent of the Issuer … receive Electricity Vendor CEA Collections from Electricity Vendors.

(f) As agent of the Issuer ... receive any amounts in respect of Clean Energy Adjustments payable directly by Specified Consumers to the Servicer (such amounts, together with the amounts referred to in Section 3.4(e), the "Servicer CEA Receipts");

(g) Deposit the Servicer CEA Receipts into the IESO Segregated Account promptly following receipt by the Servicer and, in any event, within two Business Days of receipt by the Servicer and the Issuer Share of such Servicer CEA Receipts shall remain in the IESO Segregated Account until remitted in accordance with Section 3.6;

(l) Hold the Issuer Share of Servicer CEA Receipts and the Issuer Share of any other proceeds in respect of the Clean Energy Adjustment received by it in trust for the benefit of the Issuer and remit such amounts in accordance with Section 3.6 without any surcharge, fee, offset, charge or other deduction.

Section 3.6 Remittance

(b) Absent the occurrence of a Daily Remittance Event, the Issuer Share of Servicer CEA Receipts received by the Servicer and any interest earned thereon received on or subsequent to a Remittance Date shall be remitted by the Servicer to the Collection Account no later than the immediately following Remittance Date.

(c) Following the occurrence of a Daily Remittance Event, the Issuer Share of all Servicer CEA Receipts on deposit in the IESO Segregated Account and any interest earned thereon shall be remitted by the Servicer to the Collection Account on the second following Business Day.

Section 3.7 Reimbursement of Servicer

The Issuer shall reimburse the Servicer for its direct costs relating to the performance by the Servicer of its duties and obligations hereunder and that are not otherwise recovered by the Servicer pursuant to sections 25.1(1) and 25.1(2) of the Electricity Act, 1998, which direct costs the IESO shall have no obligation to seek recovery for under sections 25.1(1) and 25.1(2) of the Electricity Act, 1998; provided, however, that this Section 3.7 shall not apply to any costs relating to the performance by the Servicer of its duties and obligations under the Act or the Regulations, including, for greater certainty the Servicer's obligations to pay monthly Carrying Costs.

Section 3.8 Limits to Obligations

Notwithstanding anything to the contrary in this Agreement, the parties hereto agree that the duties, liabilities and obligations of IESO under this Agreement are limited as provided in this Section 3.8.

(a) IESO is not responsible for, or in respect of, any amounts not collected by Electricity Vendors from their customers or not remitted by Electricity Vendors to the Servicer.

(b) IESO is not responsible to confirm, verify or audit the amount of the Clean Energy Adjustment invoiced by Electricity Vendors or the Electricity Vendor CEA Collections collected by Electricity Vendors and reported to the IESO.

(c) IESO is not responsible for enforcing the obligations of Specified Consumers to pay, or the obligations of Electricity Vendors to invoice, collect or remit Clean Energy Adjustments or any other amounts, or to establish a segregated account into which Electricity Vendor CEA Collections are to be deposited, and IESO is under no obligation to initiate or prosecute any legal action relating to the collection of the Clean Energy Adjustments or the Issuer Investment Interest.

(d) IESO is not responsible or liable for the performance by Electricity Vendors of their duties and responsibilities under the FHP Act or the Regulations including (i) the invoicing of Specified Consumers in respect of the Clean Energy Adjustment and ancillary matters related thereto; (ii) the collection from Specified Consumers of amounts due in respect of such invoices and the remittance of such payments to the Servicer; (iii) the accuracy of any information provided by the Electricity Vendors; and (iv) any reporting by the Electricity Vendors, including the reporting to the Servicer of the total CEA Consumer Invoice Amounts invoiced by such Electricity Vendor to its Specified Consumers in respect of the Clean Energy Adjustment, the total Electricity Vendor CEA Collections received by such Electricity Vendor and the Issuer Share of Electricity Vendor CEA execution, delivery and performance of all obligations under this Agreement have been duly authorized by all necessary corporate action on the part of the IESO under all applicable laws.

(e) IESO is under no responsibility or obligation to the Issuer with respect to the nature or extent of the Issuer Investment Interest, the collectability of the Issuer Share of Servicer CEA Receipts or that the Issuer Share of Servicer CEA Receipts will be sufficient to satisfy the Issuer's Funding Obligations.

(f) IESO may rely in good faith on the advice of counsel or on any document of any kind, prima facie properly executed and submitted by any Person, respecting any matters arising under this Agreement.

(g) IESO shall have no liability or responsibility to any Person in respect of any forecasts or other information provided pursuant to Section 3.2, provided only that such forecasts or other information has been prepared and provided in good faith.

(h) None of the directors, officers, employees or agents of IESO shall be liable to the Issuer or any other Person for any action taken or for refraining from the taking of any action pursuant to this Agreement or for good faith errors in judgment.

Section 3.15 IESO Security for CEA Remittances

The IESO shall provide to the Issuer, on or prior to the first day of the first Billing Period when amounts are invoiced to Specified Consumers in respect of Clean Energy Adjustments, security for any failure of Non-Investment Grade Rated Electricity Vendors to remit their Electricity Vendor CEA Collections in the form of (x) a letter of credit from a provider that satisfies the Rating Agency Condition and with a term extending to the first day of the immediately following calendar year, or (y) a performance guarantee or such other form of security as may be acceptable to the Issuer and that satisfies the Rating Agency Condition.

Section 8.7 Limitations on Rights of Third Parties

The provisions of this Agreement are solely for the benefit of the IESO and the Issuer, and such Persons shall have the right to enforce the relevant provisions of this Agreement. Nothing in this Agreement, whether express or implied, shall be construed to give to any other Person any legal or equitable right, remedy or claim in the Issuer Investment Interest or under or in respect of this Agreement or any covenants, conditions or provisions contained herein.

12. Relevant sections of the Security Agreement signed between IESO and the Fair Hydro Trust

Under Regulation 206/17 made under the FHP Act, the Grantor (ie. IESO) is required to pay to the Secured Party during the period beginning on December 1, 2017 and ending on July 31, 2021 the Carrying Costs of the Secured Party incurred during the period beginning on June 1, 2017 and ending on July 31, 2021 (the “Statutory Obligation”).

Section 2.1 Grant of Security Interest

As general and continuing security for the payment of the Statutory Obligation, the Grantor hereby grants a security interest to the Secured Party…

Relevant Accounting Guidance for Issue #3

ASC 980 *Regulated Operations*

– The Derecognition Section of ASC 980-20-40 provides guidance on determining whether and when an entity should remove an item from the financial statements. For example, the entity would derecognize an asset because it no longer has rights to the asset or it would derecognize a liability because it no longer has any obligation. [ASC 980-20-40]

– Failure of an entity's operations to continue to meet the criteria in paragraph 980-10-15-2 can result from different causes. Examples include the following:

  (a) Deregulation.

  (b) A change in the regulator's approach to setting rates from cost-based rate-making to another form of regulation.

  (c) Increasing competition that limits the entity's ability to sell utility services or products at rates that will recover costs (as used in paragraph 980-10-15-2).

  (d) Regulatory actions resulting from resistance to rate increases that limit the entity's ability to sell utility services or products at rates that will recover costs if the entity is unable to obtain (or chooses not to seek) relief from prior regulatory actions through appeals to the regulator or the courts. [ASC 980-20-15-2]

PS 1000 *Financial statement concepts*

– This Section is to be used by preparers and auditors of financial statements in exercising their professional judgment as to the application of generally accepted accounting principles and in establishing accounting policies in areas in which accounting principles are developing. [PS 1000.03]

– Financial statements should communicate information that is relevant to the needs of those for whom the statements are prepared, reliable, comparable, understandable and clearly presented in a manner that maximizes its usefulness. [PS 1000.24]

– An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph [PS 3210.04]. Thus, for example, an item does not qualify as an asset of a government if the item involves:

  (a) no future economic benefit;

  (b) future economic benefit, but the government cannot obtain it; or

  (c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred. [PS 1000.37]

PS 3050 *Loans receivable*

– A loan receivable should be removed from a government's statement of financial position when it has been repaid, the risks and rewards associated with the loan have been transferred, the right to repayment has expired or been waived, or it is written off. [PS 3050.28]

PS 3210 *Assets*

– 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. [PS3210.03]

– 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. [PS 3210.04]

– Control of an economic resource and of access to the future economic benefits are essential characteristics of an asset, whereas possession or ownership is not. [PS 3210.22]

PS 3430 *Restructuring transactions*[3]

- Individual assets and liabilities transferred in a restructuring transaction should be derecognized by the transferor if they no longer meet the definitions of assets and liabilities and applicable recognition criteria at the restructuring date. [PS 3430.21]
- When a transferor continues to be involved in the individual assets and/or liabilities it transferred to a recipient subsequent to the restructuring date, it would assess the nature and extent of its continued involvement against the definitions of assets and liabilities and applicable recognition criteria to evaluate whether: [PS 3430.24]

  (a) derecognition of the asset and liability transferred would be appropriate; and

  (b) its continued involvement gives rise to a new asset or new liability that needs to be recognized.
- A new asset or new liability may arise from a restructuring due to a transferor's continued involvement in the individual assets and liabilities transferred (for example, if it agrees to guarantee repayment of all or a portion of a transferred liability or leases back a portion of a transferred asset). As the new asset or new liability is not transferred, together with related program or operating responsibilities, they are not part of the restructuring transaction. They would be accounted for in accordance with individual Sections of the PSA Handbook by both the transferors and recipients. [PS 3430.25]

KPMG Insights into IFRS, 14th Edition 2017-2018, Section 7.5.220.10 *Structural and other liquidity risks*

- Structural liquidity risk arises primarily in securitisations when there is a mismatch between the cash inflows from financial assets and cash outflows on financial liabilities. It is important to differentiate structural liquidity risk from late-payment and default risk. For example, in a securitisation structural liquidity risk may arise because of variability in the timing of defaults on the assets whereby the structured entity that has issued securities to investors does not have enough cash to meet its obligations. This variability can arise without altering the cumulative expectation of defaults on the portfolio. In our view, this risk is not inherent in the financial asset transferred, but arises as a result of the structure of the transaction. Consequently, we believe that this risk should not be included in the risks and rewards analysis.

Deloitte, Securitization Accounting, 10th Edition January 2017, Chapter 4 *How do securitizations fare under IFRS? Page 41*

- The overall securitization has liquidity risk associated with the fact that there is a mismatch in the timing of cash inflows and outflows. It is important to recognize that liquidity risk arising in the structured entity from differences in the contractual timing of cash flows of the assets and the notes issued to acquire the assets is not part of the transferred assets. This compares to late payment risk and credit default risk which is inherent in the assets. However, if the asset pays late, the transferee may not be able to meet its obligations under the notes. This liquidity risk only arises when the assets are placed inside the securitization structure. The liquidity risk associated with late payment risk is therefore not included in the transferor's risk and rewards assessment in determining derecognition for the transferor.

[3] This Section applies to fiscal years beginning on or after April 1, 2018. […] Earlier adoption is permitted."

KPMG

Analysis of Issue #3: What is the accounting treatment for the transfer of the regulatory asset by the IESO to the Trust? More specifically, does the transfer qualify as a derecognition event for accounting by the IESO?

Before discussing whether the transfer qualifies for derecognition of the regulatory asset, we must determine the nature of the item being transferred. The IESO has recorded on its balance sheet a regulatory asset under PSAS representing the right to recover various cash costs incurred through the inclusion of those costs in the rate charged to specified consumers. Legally, the transfer is of a regulatory asset pursuant to which the financing entity will acquire a corresponding investment interest in the investment asset (Sections 26 and 27 of the FHP Act). The question is whether the regulatory asset and the investment interest in the investment asset are the same or substantially the same for purposes of the derecognition analysis. In considering this question, it is necessary to look to the FHP Act which establishes what constitutes the investment interest. Section 29 (1) thereof provides that the investment interest comprises a current and irrevocable property right and interest consisting collectively of the following, among other rights: the right to receive, collect and recover the clean energy adjustment ("CEA") from specified consumers; the right to enforce duties and obligations of the electricity vendors to charge and invoice the CEA; and all revenue, collections, claims, payments, money and proceeds derived from these rights regardless of whether they are commingled. Given that the rights of the investment interest owners comprise the entirety of the economic substance and risks of the regulatory asset as recognized by the IESO, we are of the view that they are the same. Accordingly, although legally the transfer is of the regulatory asset pursuant to which the financing entity acquires a corresponding investment interest, we view the substance as being the same as a transfer of the regulatory asset, which leads us to the analysis below as to whether the transfer qualifies as a derecognition event from an accounting perspective.

For clarity, in the discussion below we will use the term 'regulatory asset' to refer to the investment interest.

ASC 980 does not provide clear detailed guidance for the derecognition of a regulatory asset other than in connection with the discontinuation of rate-regulated accounting. However, ASC 980-20-40 provides general principles for the derecognition of assets:

– *Derecognition Section provides guidance on determining whether and when an entity should remove an item from the financial statements. For example, the entity would derecognize an asset because it no longer has rights to the asset or it would derecognize a liability because it no longer has any obligation.*

In the context of this limited guidance alone, we could conclude that IESO should derecognize the regulatory asset when it transfers the regulatory asset and the corresponding investment interest is acquired by the Trust, given the following provisions of the arrangement and related legislation:

FHP Act, Section 27 (1) (2) (Emphasis added below):

– *A transfer of a specified portion of the regulatory asset under section 26 constitutes a valid and enforceable absolute assignment, conveyance and sale of the corresponding investment interest to the transferee.*

– *Without limiting subsection (1), any transfer agreement that states an intention of the parties for IESO to dispose of a specified portion of the regulatory asset and to assign, convey or sell a corresponding investment interest shall be treated for all purposes as an absolute assignment, conveyance, disposition and sale of IESO's right to recover the corresponding amount in the variance account and not merely as a security interest.*

Further, pursuant to Sections 30 and 32 of the FHP Act, the investment interest owner (i.e. the transferee) has the right to either sell its investment to another investment interest owner or to grant a security interest over all or a specified portion of its right, title and interest in, to and under the investment interest to or in favour of any person to secure a funding obligation. The ability to do so provides additional evidence that the transferee may realize its asset without any involvement by IESO.

It should also be noted that PSAS provides limited guidance on derecognition of financial assets. PS 3050 *Loans receivable*:

- *A loan receivable should be removed from a government's statement of financial position when it has been repaid, the risks and rewards associated with the loan have been transferred, the right to repayment has expired or been waived, or it is written off.*

As noted in Section 27(1) and (2) of the FHP Act, the asset has been absolutely assigned, conveyed and disposed of; the transfer is not merely to effect a security interest.

In addition, PS 1000 *Financial statement concepts* and PS 3210 *Assets* provide general guidance on the recognition and derecognition of an asset:

- *An item does not qualify as an asset of a government if the item involves:*
  - *(a) no future economic benefit;*
  - *(b) future economic benefit, but the government cannot obtain it; or*
  - *(c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred.*

These considerations are discussed further below, as relevant.

Furthermore, it should also be noted that PSAS provide limited guidance on derecognition of non-financial assets. Section 3430 *Restructuring transactions,* which is applicable for fiscal years on or after April 1, 2018 with early application permitted, has guidance for the derecognition of assets.

- *Individual assets… transferred in a restructuring transaction should be derecognized by the transferor if they no longer meet the definitions of assets… and applicable recognition criteria at the restructuring date.*
- *When a transferor continues to be involved in the individual assets … it transferred to a recipient subsequent to the restructuring date, it would assess the nature and extent of its continued involvement against the [definition] of assets … and applicable recognition criteria to evaluate whether derecognition of the asset transferred would be appropriate and whether its continued involvement gives rise to a new asset or new liability that needs to be recognized.*

Recognizing the proposed transaction is not a restructuring transaction, Section 3430, which has recently been issued by PSAB, provides current evidence of thinking in the application of the general PSAS principles in respect to the recognition and derecognition of assets.

Accordingly, the analysis as to whether the regulatory asset transferred to the Trust can be derecognized is based on the foregoing guidance.

Criteria for the recognition of an asset

PS 3210.03 states that 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. More generally, PS 1000.37 suggests that an asset would no longer be recognized if it fails to meet the definition of an asset:

Criteria	Comment	Evaluation
Assets (PS 3210.04/ PS 1000.36) (Emphasis added)*:* 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 <u>provide future cash inflows</u>, 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. *Financial statement concepts (PS 1000.37):* An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph [see above]. Thus, for example, an item does not qualify as an asset of a government if the item involves: (a) no future economic benefit (b) future economic benefit, but the	Based on the accounting guidance, the regulatory asset transferred to the Trust does not qualify as an asset of IESO if they cannot obtain the future economic benefits. PS 1000 *Financial statement concepts* and PS 3210 *Assets* state that: – *… an item does not qualify as an asset of a government if the item involves future economic benefit, but the government cannot obtain it.* – *Control of an economic resource and of access to the future economic benefits are essential characteristics of an asset, whereas possession or ownership is not.* Upon transfer of the regulatory asset, the IESO has no further rights or obligations in connection to the asset transferred, other than the contractual obligation to act as the Servicer of the asset transferred and the security granted to the Trust discussed below. Interest earned on the cash collected by IESO as the Servicer is required to be transferred to the Trust. The Trust has provided to the Indenture Trustee a security over the regulatory asset acquired from the IESO. The Trust has the right to sell the acquired regulatory asset to other parties. These conclusions are supported by the FHP Act, the MTSA Agreement and Stikeman Elliott LLP. The FHP Act notes that: – *IESO may from time to time, in accordance with this Act and the regulations, transfer a specified portion of the regulatory asset to a financing entity in accordance with this section.* – *Upon receipt by IESO of the payment by the financing entity, IESO shall retain no further right, title or interest in the corresponding investment interest.* – *A transfer of a specified portion of the regulatory asset under Section 26 constitutes a valid and enforceable absolute assignment, conveyance and sale of the corresponding investment interest to the transferee.* – *Without limiting subsection (1), any transfer agreement that states an intention of the parties for IESO to dispose of a specified portion of the regulatory asset and to assign, convey or sell a corresponding investment interest shall be treated for all purposes <u>as an absolute assignment, conveyance, disposition and sale of IESO's right to recover the corresponding amount in the variance account and not merely as a security interest.</u>*	Not an asset of the IESO

Criteria	Comment	Evaluation
government cannot obtain it.	– *At the time a transfer of the regulatory asset is made, the transfer shall be deemed to have been and shall be perfected, vested, valid and binding as against the transferor and all other persons who have claims of any kind against the transferor.* – *An investment interest owner may grant a security interest over all or a specified portion of its right, title and interest in, to and under the investment interest to or in favour of any person to secure a funding obligation.* The MTSA Agreement notes that: – *IESO shall establish an Eligible Deposit Account bearing a designation indicating that the funds deposited therein are held in trust for the benefit of the Issuer.* – *IESO shall remit the CEA Receipts received and any interest earned thereon to the Trust.* – *The duties, liabilities and obligations of IESO under the MTSA Agreement are limited, especially that the IESO is not responsible for any amounts not collected by Electricity Vendors from their customers or not remitted by Electricity Vendors to the Servicer.* There is no contractual restriction preventing the Trust from selling or pledging the regulatory asset acquired from IESO. In fact, the Trust has granted a security interest over all its right, title and interest in, to and under the investment interest to the Indenture Trustee to secure future funding obligations. Furthermore, the Trust has the right to sell the asset to another party in accordance with the Financing Plan (which is to be established by OPG as the Financial Services Manager). The FHP Act notes that: – *Upon transfer, the financing entity becomes an investment asset owner and acquires an investment interest.* – *An investment interest owner may transfer all or a portion of an investment interest to any other investment interest owner.* – *An investment interest owner may grant a security interest over all or a specified portion of its right, title and interest in, to and under the investment interest to or in favour of any person to secure a funding obligation.* Although not specifically a requirement in PSAS, in determining whether a transfer has been substantively effected in a securitization transaction, other accounting frameworks consider whether a transfer would survive the possibility of bankruptcy of the transferor, regardless of how	

Criteria	Comment	Evaluation
	remote insolvency may appear given the transferor's credit standing at the time of securitization, and irrespective of an entity's credit rating. That is, whether creditors of the transferor would have rights to the transferred assets in a bankruptcy claim. Put differently, would the transfer be undone if the transferor were to become a bankrupt. In that respect, IESO has obtained a legal opinion from Stikeman Elliott LLP. Paragraphs 12 and 13 of the legal opinion state that: – *The transfer by the IESO of the specified portion of the regulatory asset provided for in the Initial Transfer Notice would not be declared void or be set aside by a court as a preference or a fraudulent conveyance upon the application of a Creditor pursuant to the applicable preferences and fraudulent conveyances provisions of any of the Insolvency Statutes and would not be held by a court to constitute a transfer at undervalue under the Insolvency Statutes.* – *The Trust is a separate entity from the IESO, and absent an agreement to the contrary or a further transfer of the investment interest, (i) in a bankruptcy or insolvency proceeding under the Insolvency Statutes in relation to the IESO, the corresponding investment interest would not constitute property of the IESO within the meaning of the applicable Insolvency Statutes (ii) the Trust would not be legally responsible for the general obligations of the I ESO and (iii) creditors of the IESO could not look successfully to the corresponding investment interest to satisfy a claim which they may have against the IESO.* Based on the above facts, and on the FHP Act, MTSA Agreement and the legal opinion, it is clear that IESO will have no rights to the economic benefits associated with the future cash inflows related to the regulatory asset transferred to the Trust - it will have transferred its right to recover the IESO deferral to the Trust. Further, it is also clear that IESO will lose control over the regulatory asset once it is transferred to the Trust.	

As mentioned above, and recognizing the proposed transaction is not a restructuring transaction, Section 3430 provides guidance by analogy, on how to account for and report restructuring transactions by transferors of assets. PS 3430.24 requires an entity to assess whether it should continue to recognize an asset (legally) transferred when a transferor continues to be involved in the individual assets it transferred to a recipient subsequent to the restructuring date. However, PS 3430.24 provides no guidance to help a preparer assess whether the continuing involvement is of the type to prohibit derecognition. However, both US GAAP and IFRS have guidance to which we have looked to assist in the application of PS 3430 for both the continuing involvement condition (US GAAP and IFRS) and the risk/rewards analysis (IFRS).

Criteria	**Comment**	**Evaluation**
Restructuring transactions (PS 3430.24): When a transferor continues to be involved in the individual assets…it transferred to a recipient subsequent to the restructuring date, it would assess the nature and extent of its continued involvement against the definitions of assets…and applicable recognition criteria to evaluate whether: (a) derecognition of the asset…transferred would be appropriate; and (b) its continued involvement gives rise to a new asset or new liability that needs to be recognized. [PS 3430.24] *(PS 3430.24):* A new asset or new liability may arise from a restructuring due to a transferor's continued involvement in the individual assets and liabilities transferred	By analogy to PS 3430, one assesses whether the regulatory asset transferred to the Trust should be derecognized and whether a new asset or liability arises due to the IESO's continued involvement in the collection of the regulatory asset transferred to the Trust. Based on the analysis above, the derecognition of the asset is appropriate subject to further assessment of the three issues mentioned below. Based on an analysis of the MTSA Agreement and the Regulations, we have identified three additional items of continued involvement that need to be assessed: the security granted by the IESO to the Trust, the carrying costs to be paid by the IESO during the period to July 31, 2021, and the IESO's costs incurred as the Servicer. *Security granted to Trust* The issue is whether the security granted to the Trust would not allow the IESO to derecognize the regulatory asset transferred to the Trust. Before addressing the security granted to the Trust, it should be noted that the FHP Act allows the Trust to recover from the specified consumers, through the true up mechanism, any CEA amount uncollected, including the CEA amount collected by the Electricity Vendors but not remitted to IESO. Section 15 of FHP Act and the Regulation 206/17 note that: – *The Financial Services Manager shall determine the CEA <u>payable by all specified consumers</u> in respect of each month in a reference period by taking the following steps:* *1. Calculate the sum of the following:* *i. The estimated finance amount in respect of the reference period.* *ii. <u>The true up amount</u> in respect of the reference period.* *2. Divide the sum calculated under par. 1 by the number of months in the reference period.*	Derecognition criteria met; No new asset or liability to recognize

Criteria	Comment	Evaluation
(for example, if it agrees to guarantee repayment of all or a portion of a transferred liability or leases back a portion of a transferred asset). As the new asset or new liability is not transferred, together with related program or operating responsibilities, they are not part of the restructuring transaction. They would be accounted for in accordance with individual Sections of the PSA Handbook by both the transferors and recipients. [PS 3430.25]	– *The determination of the true up amount should take into account historical and reasonably foreseeable,* i. *differences between the estimated and actual finance amount for the applicable reference period,* *ii. differences between amounts invoiced and amounts collected due to various factors, including applicable taxes, consumer defaults and delays, billing lags and write-offs, and* *iii. variations in billings due to variations in electricity consumption. (Emphasis added)* Furthermore, the MTSA Agreement states that: – *The duties, liabilities and obligations of IESO under the MTSA Agreement are limited, especially that the IESO is not responsible for any amounts not collected by Electricity Vendors from their customers or not remitted by Electricity Vendors to the Servicer.* In fact, the purpose of the security is to address the liquidity risk related to the failure of *Non-Investment Grade Rated Electricity Vendors to remit their Electricity Vendor CEA Collections*. As a result, IESO is required to provide security to the Trust pursuant to Section 3.15 of the MTSA Agreement as follows: – *The IESO shall provide to the Trust, security for any failure of Non-Investment Grade Rated Electricity Vendors to remit their Electricity Vendor CEA Collections in the form of (x) a letter of credit from a provider that satisfies the Rating Agency Condition and with a term extending to the first day of the immediately following calendar year, or (y) a performance guarantee or such other form of security as may be acceptable to the Issuer and that satisfies the Rating Agency Condition.* The amount of the security is estimated at around $100 million based on the formula described in Section 3.15. As discussed above, recognition and derecognition of assets under PSAS is based on a risks and rewards model. When performing an assessment for the derecognition of an asset in a securitization arrangement, we look at the risks and rewards associated with ownership of the asset. Those are risks that are inherent in the asset that is being transferred prior to its transfer. For example, 'late-payment risk' (i.e., the risk that the asset's obligor does not pay its obligation as due) is considered in the risks and rewards analysis. However, late payment by the transferor of cash collected, is not thought as	

Criteria	Comment	Evaluation
	a risk or reward associated with the transferred asset as it is not a risk or reward that was inherent in the asset prior to its transfer. The default risk contemplated in the security relates to the Electricity Vendors not remitting received CEA Receipts to IESO. It is not a security against the failure of the specified consumers to remit amounts due to the Electricity Vendors. There is no guidance on this issue under PSAS and limited guidance under other accounting frameworks on this issue. In our view, the risk of the Electricity Vendors not paying the cash it has collected is not inherent in the asset transferred, but arises as a result of the structure of the transaction. We believe that this risk is more analogous to structural liquidity risk. As noted earlier, PSAS has no guidance on the assessment of the risk and reward analysis, particularly as it relates to the security. IFRS, given its risk/rewards criterion (as the first step in determining whether derecognition has been achieved) has guidance to which one may analogized. KPMG and Deloitte[4] provide guidance on the accounting implications structural liquidity risk of securitization transactions. KPMG Insights into IFRS, 14th Edition 2017-2018, Section 7.5.220.10 states: – *It is important to differentiate structural liquidity risk from late-payment and default risk.* – *For example, in a securitization structural liquidity risk may arise because of variability in the timing of defaults on the assets whereby the structured entity that has issued securities to investors does not have enough cash to meet its obligations. This variability can arise without altering the cumulative expectation of defaults on the portfolio. In our view, this risk is not inherent in the financial asset transferred, but arises as a result of the structure of the transaction. Consequently, we believe that this risk should not be included in the risks and rewards analysis.* Furthermore, it should be noted that the IESO has been granted a right to recover any cost incurred related to the security from the specified consumers. A provision has been added to Section 10.2 of Regulation 429/04, which will come into force in 2021, which is when the IESO's security will be put in place: – *The IESO shall, in respect of each month, determine the rate payable by specified consumers in respect of the costs incurred by the IESO to fulfil its obligations, if any, under an agreement with a financing entity to provide security…*	

[4] In our survey of PWC's and EY's publicly available guidance, we found no guidance on structural liquidity risk.

Criteria	Comment	Evaluation
	Consequently, we believe that the structural liquidity risk should not be included in the risks and rewards analysis. *Carrying costs incurred by the Trust* The issue is whether a financial liability should be recognized on Day 1 for the carrying costs to be paid by the IESO during the period to July 31, 2021. The carrying costs include the funding cost (interest) and the financial entity expenses (operating costs incurred by the Trust). Section 9.1 of Ontario Regulation 206/17 notes that: – The IESO shall pay and remit to the Trust any amounts charged to the IESO by the Trust in respect of carrying costs of the Trust during the period from June 1, 2017 to July 31, 2021. – The IESO may grant security to the Trust in order to secure its obligations to pay and remit present and future amounts due under this section. – The carrying costs include the funding cost (interest, commitment fees or other similar costs payable by the Trust in respect of funding obligations), as well as the financial entity expenses (operating costs incurred by the Trust). *Financial entity expenses.* In our opinion, the operating costs incurred by the Trust are period costs, and no accrual should be made in advance of payment for these expenses as the operating costs incurred by the Trust which give rise to the payment requirement have not occurred yet. *Funding cost*. In our opinion, a financial liability should be recognized to cover the funding cost for the period from June 1, 2017 to July 31, 2021 only if there is a contractual obligation between the IESO and the Trust. The obligation to pay for the funding cost has been established by the Ontario Regulation 206/17 instead of a contractual obligation between the IESO and the Trust. As a result, there is no requirement to set up a financial liability on the derecognition of the regulatory asset transferred to cover the funding cost. A financial liability will be recognized when the carrying costs are invoiced by the Trust to the IESO.	

Criteria	Comment	Evaluation
	Costs of the IESO as the Servicer PS 3430.24 notes that “a new asset or new liability may arise from a restructuring due to a transferor's continued involvement in the individual assets and liabilities transferred.” Other accounting frameworks (US GAAP and IFRS) have identified a requirement to consider whether as a result of a requirement to service transferred financial asset there exists a servicing asset or liability. In this instance, IESO is required to service the transferred investment interest. Thus, there is an issue as to whether a servicing liability should be recognized on Day 1 given that the IESO is not receiving any additional compensation for servicing. Under these other accounting frameworks, when there is no servicing fee specified, or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognized at fair value. The MTSA Agreement notes that: – *The Issuer shall reimburse the Servicer for its direct costs relating to the performance by the Servicer of its duties and obligations hereunder…* As a result, since the IESO will be adequately compensated for performing the servicing, there is no requirement to recognize a liability for the servicing obligation. That is, as the IESO will be adequately compensated for the servicing activities it performs in the future, and as both sides of this future transaction are equally unfulfilled (i.e., servicing by IESO and obligation of the Trust to compensate IESO for that servicing), no liability would be recognized on Day 1.	

Management conclusion

IESO management has concluded that the regulatory asset should be derecognized upon transfer of the investment interest in the regulatory asset to the Trust.

The transfer of a specified portion of a regulatory asset transfers the control and the benefits associated with the right to collect cash flows in the future arising in investment asset acquired by the Trust. This will eliminate the IESO regulatory asset in the amount of the transfer to the Trust as the IESO will no longer control an economic resource or have access to future economic benefits of that asset. The funds collected from the transfer will in turn reduce the associated debt held by the IESO, maintaining the IESO’s net $ nil balance in the market accounts.

Our conclusion

We have considered the foregoing analysis and management's conclusion. We concur with management's conclusion that the regulatory asset should be derecognized on transfer to the Trust as IESO no longer has rights or future economic benefits associated with the asset.

Other Matters

The ultimate responsibility for the decision on the appropriate application of PSAS for the specific transactions rests with management as preparers of the financial statements. Our judgment on the appropriate application of PSAS for the specific transaction is based solely on the facts, circumstances and assumptions provided to us as described above. Should these facts and circumstances differ, our conclusion may change.

The opinions expressed herein are as of the date of this letter only and as such we assume no obligation to update or supplement such opinion to reflect any facts or circumstances that may come to our attention after that date or any changes in generally accepted accounting principles, including but not limited to US GAAP, PSAS or IFRS that occur or become effective after that date.

This letter is intended solely for the information and use of the Board of Directors and management of the Company, and is not intended to be and should not be used, quoted, relied upon by, or otherwise referred to by anyone other than these specified parties or for any other purpose without our express written consent.

No one other than the Board of Directors and management of the Company is authorized by KPMG to rely upon any information or views expressed herein. KPMG shall have no responsibility or liability for loss or damages or claims, if any, to or by any third party as this letter has not been prepared for, and is not intended for, and should not be used by, any third party or for any other purpose.

Yours very truly,

KPMG LLP

Michel Picard
Partner
(416) 777 8414
mpicard@kpmg.ca