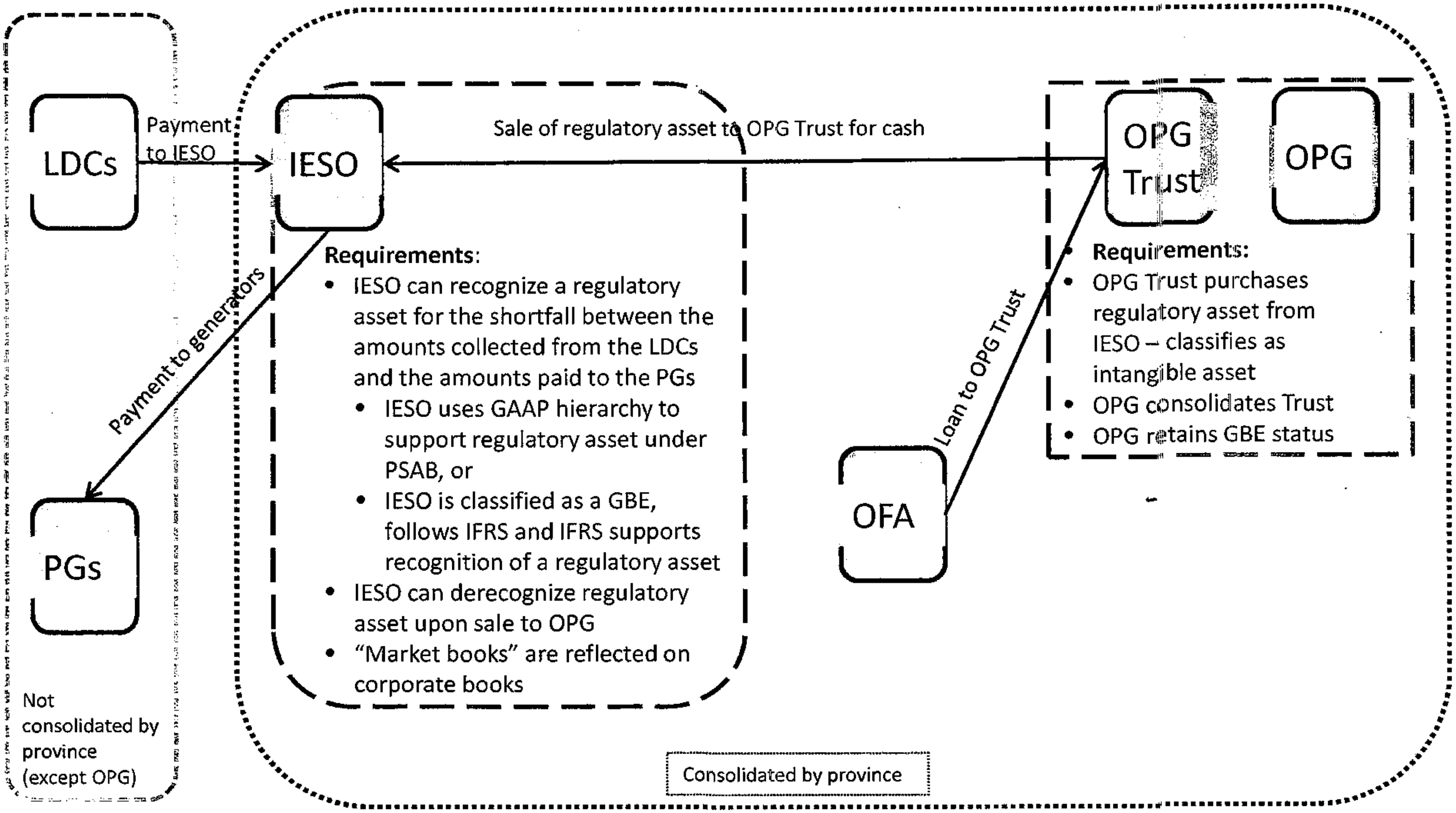
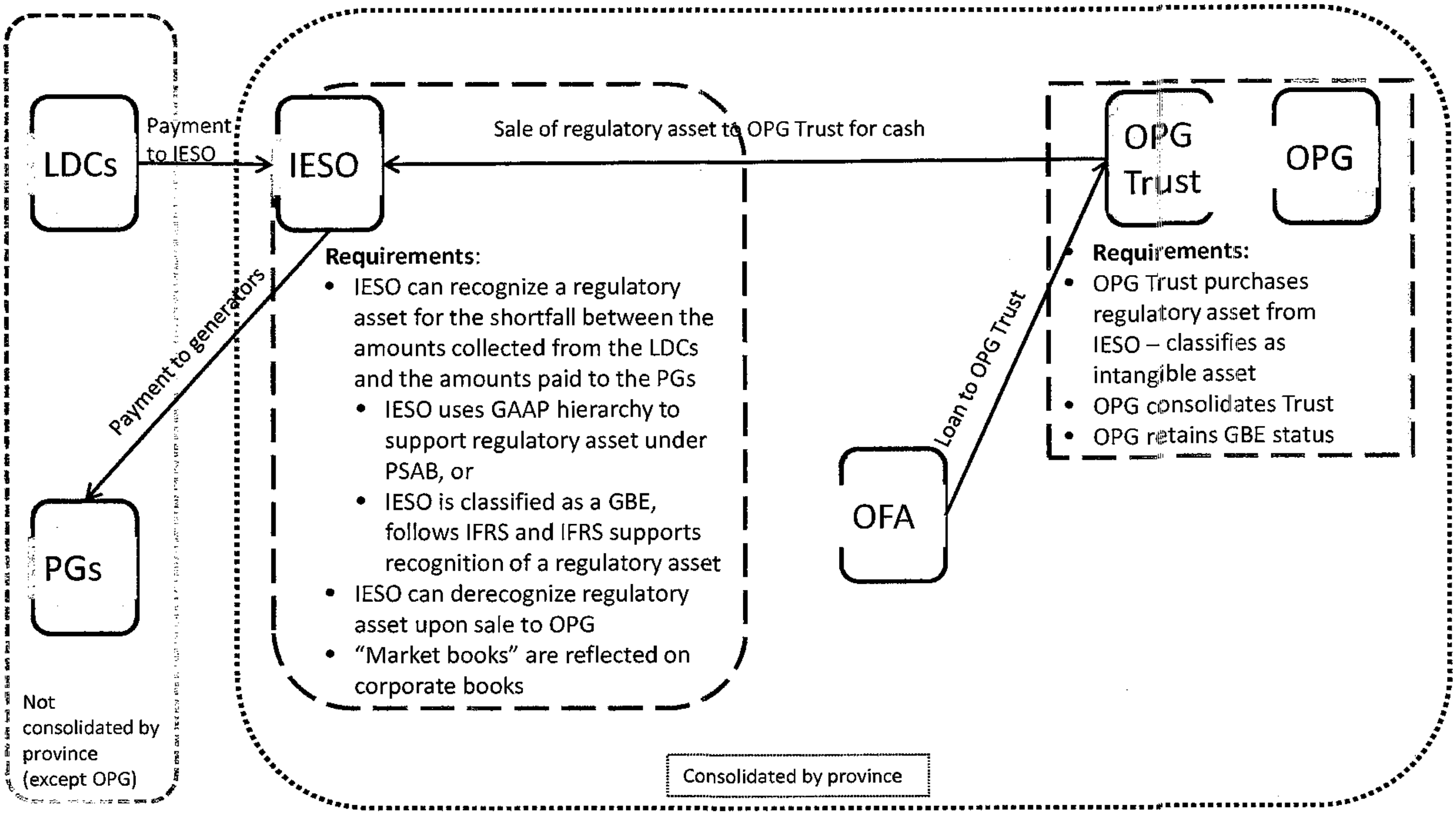
# Potential Structure – Feb 13/17



# Potential Structure – Feb 13/17




Draft -- for discussion only

# AG Concerns

## Backpocket

# Rate-Regulated Assets and Liabilities

## AG Observations:

- The AG continues to express his concerns with the use of rate-regulated accounting and the appropriateness of recognizing rate-regulated assets and liabilities in the province's consolidated financial statements.
- The AG provides the following reasons as justification for removing rate-regulated deferred assets and liabilities from the province's consolidated financial statements:
  - he feels that they may not meet the definition of an asset or liability, and
  - the government, rather than an independent regulator, has significant influence on what costs are recognized in a given year.

- The AG also notes that the rate-regulated accounting impacts on Ontario Power Authority's (OPA) results should have been removed upon consolidation into the province's financial statements given that it is not a government business enterprise. However, not making the adjustment did not have a material impact on the 2010-11 results or his audit opinion.
- He notes that standards setters have been reviewing the use of rate-regulated accounting in light of the adoption of International Financial Reporting Standards (IFRS) by government business enterprises.
  - While the utility industry fully supports rate-regulated accounting, the majority of accounting bodies and standards setters who responded to proposed exposure drafts on the standards disagreed.
  - He does note that the U.S. standards setter does not agree with its international counterparts and fully supports rate-regulated accounting.

# Rate-Regulated Assets and Liabilities (cont'd)

- Given this position, and that continued work on rate-regulated accounting standards has been deferred, he concludes that the era of rate-regulated accounting is coming to a close in Canada and that IFRS is the new standard to be followed, and therefore, rate-regulated accounting should no longer be used.
- The AG does not agree with the Ministry of Finance's position, that the province's rate-regulated assets and liabilities meet PSAB's standards, without reference to any of the rate-regulated provisions in the Canadian Institute of Chartered Accountants Handbook. It should be noted that in his 2010 report, he did accept this accounting treatment. The difference in viewpoint is due to PSAB now following IFRS (effective January 2012), which is silent on rate-regulated accounting.
- The AG indicated a potential issue in next year's audit if rate-regulated assets and liabilities continue to be included in the province's financial statements and, due to consolidation of Hydro One, Ontario Power Generation and OPA, have a material impact on the consolidated results of the province.
- The AG notes that the government has directed Hydro One (through a regulation) to prepare its future financial statements in accordance with U.S. generally accepted accounting principles (GAAP). He is concerned about the province using legislation to override Canadian GAAP, departing from a tradition of complying with Canadian accounting standards.

# Rate-Regulated Assets and Liabilities (cont'd)

**Ministry of Finance's Response:**

*The Ministry recognizes the challenges in the accounting standards setting environment to achieve consensus on the required approach for rate-regulated accounting. Given the deferral by the standards setters to resolve this issue, the government directed Hydro One to follow U.S.GAAP to allow it to continue to account for these rate-regulated assets and liabilities as it has historically been able to do under Canadian GAAP. This decision is consistent with actions by both the Canadian Securities Administrators and the Ontario Securities Commission which enabled rate-regulated utilities to submit their financial statements on a U.S. GAAP basis until 2014.*

*The government looks forward to the standards setters undertaking actions to complete their efforts to resolve the outstanding rate-regulated accounting concerns and update the standards accordingly.*

- **AG's Position on Rate Regulated Accounting on Province's Books**
- Chapter 2 of the Auditor General's Annual 2011 Report included a section on rate-regulated assets and liabilities which discussed the following:
- The net impact on reducing the reported Provincial deficit as a result of rate-regulated accounting.
- Whether rate-regulated assets and liabilities met the definition of assets or liabilities for the purposes of the Province's consolidated financial statements.
- The impact on the Province's consolidated statements due to the consolidation of Ontario Power Authority's results which include rate-regulated assets and liabilities.
- The Auditor General of Ontario's position that the Province of Ontario's rate-regulated assets and liabilities do not meet PSAB's standards for recognition in the Province's consolidated financial statements.
- Hydro One's use of US GAAP.
- The future disposition of OPG's and the OPA's rate-regulated assets and liabilities.
- The use by the Province of Ontario of legislation to override Canadian GAAP.

- The 2012 Audit Issues Letter Addressed to the Director, Accounting Policy and Financial Reporting noted:
- using rate regulated accounting reduces transparency as government has significant influence over what costs will be recognized as expenses in the electricity sector in any given year given the "regulator" is a government controlled entity.
- Noted that Ontario Securities Commission acceptance of the use of US GAAP by both OPG and HOI may provide legitimacy to this practice; however, in evaluating the province's consolidated financial statements, it remains the AG's view that accounting principles for government are those recommended by the Canadian Institute of Chartered Accountants.
- It is not the impact of this decision on HOI's and OPG's financial statements that is of concern, but the impact on the province's consolidated financial statements.
- It will be necessary to determine if the effects will be material not only for this year's audit, but also for future years' audits (differences on the province's reported annual deficit/surplus, net debt and accumulated deficit on a post-consolidation basis would be accounting errors, resulting from accounting practices that do not comply with accounting standards recommended by the Canadian Institute of Chartered Accountants).
-

# IESO

- IESO collects from LDCs -- $90
- IESO sells right to collect from LDCs from amount deferred to OPG
- IESO pays generators

# Assumptions

- Amount paid to generators for GA – paid by IESO - $100
- Amount collected from LDCs for GA – paid to IESO -- $90
- Amount collected from OPG for right to collect $10 + interest in the future from LDCs based on future consumption -- $10

- Accounting by IESO
  - IESO is a GBE and follows regulatory accounting
    - Regulatory asset of $10
    - Debt owed to OPG of $10

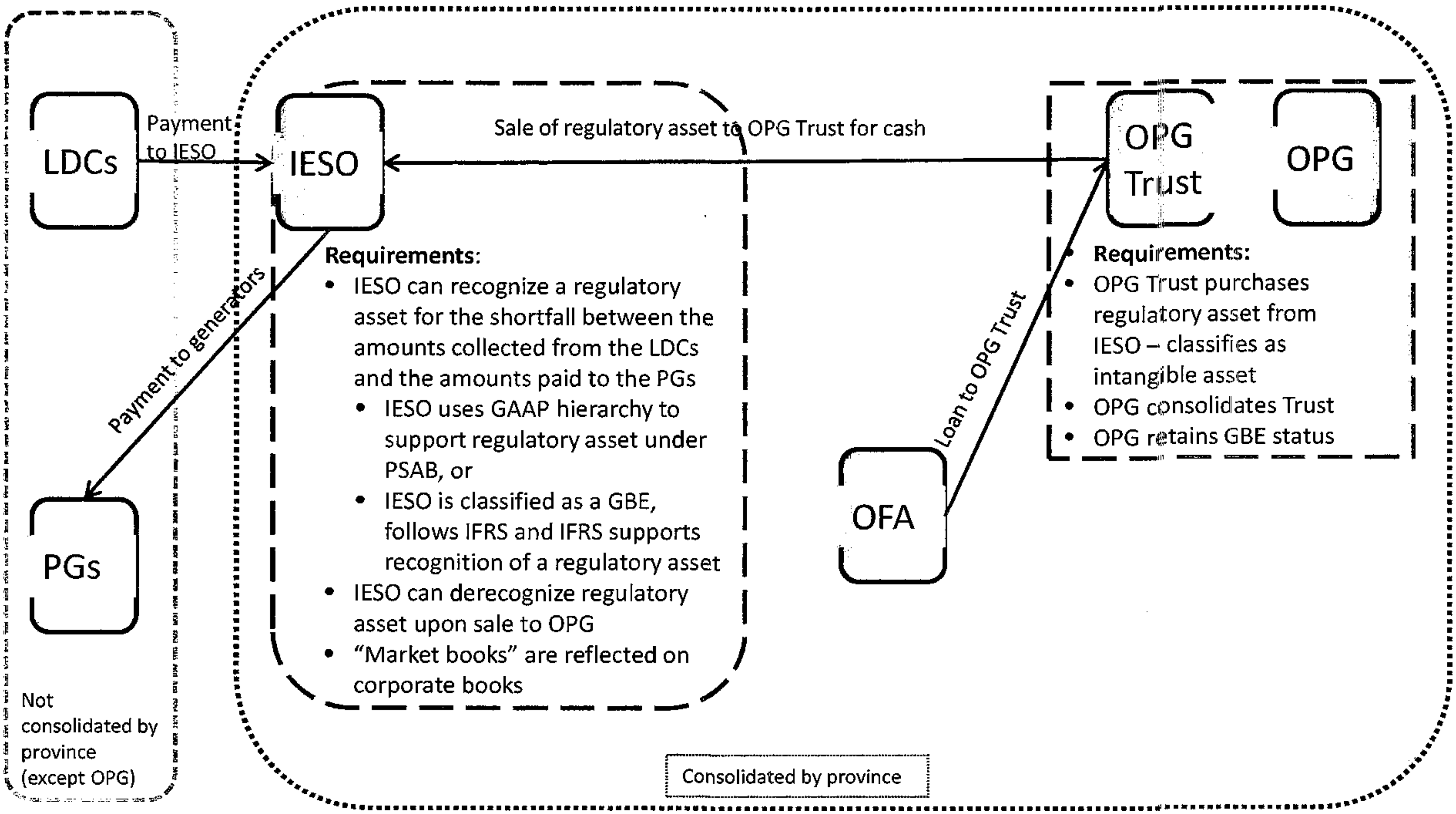
- Accounting by OPG (finance subsidiary or OPG operating)
  - Debt receivable from IESO -- $10
  - Debt payable to OFA -- $10

- Provincial consolidation
  - Debt receivable (OFA from OPG) -- $10
  - Debt payable – (OFA borrowing) - $10

- Do we need OPG of rate regulated accounting is supportable by IESO -- NO

| | IESO is a GBE | IESO is not a GBE |
|---|---|---|
| History | Not supportive | Supportive – historical analysis completed and accounting framework selected |
| What can be changed to support GBE treatment | Self-sustaining in normal course<br>- Could be supported today – break even entity –able to recover its cost from the market<br>- In the future, if the IESO takes on $30B of debt without any ability to service debt, how can this be supported?<br>- Is it self-sustaining because it has the right to collect fees in the future based on consumption<br>• How does the length of time between financing and repayment come into play<br>• Risk of government changing the legislation to reduce the impact on future ratepayers | N/A |
| Could rate regulated accounting be applied | Rate regulated assets are recognized under IFRS<br>• Is the cost paid to the generators and not yet collected from the LDCs, a cost "incurred" by the IESO?<br>• How does the historical accounting as an agent (from an income statement perspective), support this?<br>• Does the change in role of the IESO support the use of rate regulated accounting<br>• Is there support that historically, rate regulated accounting was used (will be circular – have to be able to support recognition of rate regulated accounting historically based on PSAB – see next column | Support the recognition of rate regulated assets through the GAAP hierarchy<br>- IFRS, US GAAP, ASPE, GAST, IPSASB(?)<br>- Any other entities using PSAB that recognize regulatory assets?<br>- Does it meet the definition of an asset using the new section?<br>- How does the recognition of a regulatory asset fit into the current conceptual framework or the prohibition on the recognition of an intangible – is the regulatory asset an intangible (how it is defined in the other standards) |

# Potential Structure – Feb 13/17



# Assumptions

- Amount paid to generators for GA – paid by IESO - $100
- Amount collected from LDCs for GA – paid to IESO -- $90
- Amount collected from OPG for right to collect $10 + interest in the future from LDCs based on future consumption -- $10

- Accounting by IESO
  - No regulatory accounting:
    - Fiscal expense of $10
    - Debt owed to OPG of $10
  - Regulatory Accounting
    - Regulatory asset of $10
    - Debt owed to OPG of $10

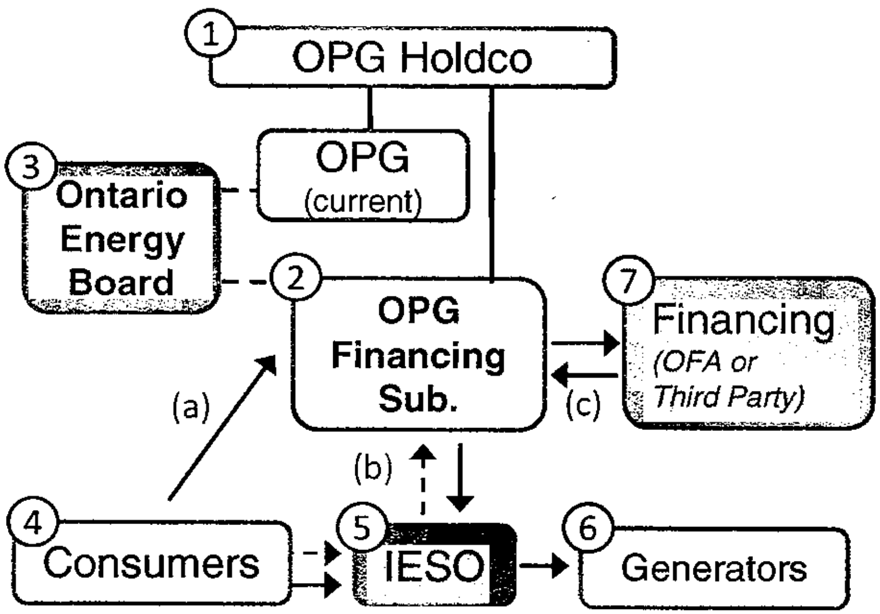
- Accounting by OPG (finance subsidiary or OPG operating)
  - Debt receivable from IESO -- $10
  - Debt payable to OFA -- $10

- Provincial consolidation
  - Debt receivable (OFA from OPG) -- $10
  - Regulatory asset or fiscal expense (IESO) -- $10
  - Debt payable – (IESO to OPG ) -- $10
  - Debt payable – (OFA borrowing) - $10

- Do we need OPG of rate regulated accounting is supportable by IESO -- NO

# 1. GA Smoothing – Option A: OPG

- The diagram outlines a implementation approach that includes a Financing Subsidiary of OPG.




Early year fund flow

Future Repayment Mechanism

1. OPG would create a holding company which would own shares in the existing OPG Inc., as well as a new Financing Subsidiary.
2. The OPG Financing Sub. funds part of the GA and (a) would have a legislative right to recover associated principle, interest and administrative costs from customers (settled via service agreement with IESO).
3. OEB, while continuing to regulate the current OPG, provides light-touch oversight of the OPG Financing Sub., as well as the GA smoothing mechanism.
4. Consumers pay IESO a portion of the GA in early years. In the future, the OPG Financing Sub. recovers principle, interest and administrative costs from consumers. Customers bill presentation remains unchanged (costs should diminish in early years).
5. The IESO pays generators (in early years), partially from consumers and partially financed by the OPG Financing Sub. (b) The IESO provides collection services to the Financing Entity under a service contract.
6. Generators continue to receive payments from IESO according to existing contract / regulatory structures.
7. The OFA or a 3rd party lender funds the GA shortfall in early years and (c) receives payments from the OPG Sub. as debt is repaid.