December 21, 2017

# DAY 2 ACCOUNTING CONSIDERATIONS FOR THE FAIR HYDRO PLAN UNDER IFRS

***Purpose:***

This document summarizes the preliminary views of Ontario Power Generation (OPG or the Company) on the theoretical accounting impacts to OPG, through consolidation, of the transactions related to the deferral of a portion of the Global Adjustment (GA) for the benefit of specified consumers resulting from Ontario's Fair Hydro Plan under IFRS. Specified consumers are regulated price plan consumers that are residential, farm, small businesses and other eligible consumers who are benefitting from the 25% rate reduction.

The Fair Hydro Trust (the Trust) is being established to be the financing entity contemplated by the Ontario Fair Hydro Act, 2017 (the Act) and OPG has been designated as the Financial Services Manager (FSM). Please refer to the separate accounting memo entitled "Consolidation Considerations of the Fair Hydro Trust Under IFRS" for OPG's consolidation analysis under IFRS.

***Key Transactional Highlights:***

Please refer to the memorandum entitled "Day 2 Accounting Considerations of Ontario's Fair Hydro Plan under US GAAP" for background on the transaction.

***Status of Program Agreements:***

As of the date of this memorandum, the program documents/agreements referenced herein have not been executed or finalized. The versions or dates of the documents are as follows:

- Master Transfer and Servicing Agreement – December 14, 2017 (latest version submitted to credit rating agencies)
- Management Agreement – December 14, 2017 (latest version submitted to credit rating agencies)
- Financing Plan – December 1, 2017 (latest version submitted to the Province)

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***Accounting Issues:***

**A. How should this Global Adjustment (GA) deferral asset be classified and subsequently measured under IFRS?**

**B. How should revenue and expenses related to the GA deferral asset be accounted for under IFRS?**

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***Accounting Analysis:***

**A. How should this GA deferral asset be classified and subsequently measured under IFRS?**

Management considered all of the possible asset classifications that could characterize the Fair Hydro Trust's (Trust) GA deferral asset including (i) financial asset, (ii) intangible asset, and (iii) regulatory asset.

***IAS 32, paragraph 11*** states that a **financial asset** is any asset that is:

(a) *Cash;*

**Not applicable.** The right to collect deferred revenue from future specified creditors does not represent cash presently.

(b) *An equity instrument of another entity;*

**Not applicable.** The GA deferral asset does not represent the equity instrument of another entity.

(c) *A contractual right:*

(i) *To receive cash or another financial asset from another entity; or*

(ii) *To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or*

**Not applicable.** The Trust is expecting to receive cash for the GA deferral assets it has acquired from a pool of specified consumers who benefitted from the lower electricity rates, not a specified other entity (i.e. IESO). In coming to this conclusion, management first considered whether the Master Transfer and Servicing Agreement (MTSA) with the IESO meets criterion c(i). The MTSA establishes a contractual right for the Trust to receive carrying costs payments from the IESO during the period from December 1, 2017 to July 31, 2021 pursuant to section 9.1 (1) of the General Regulation and CEA payments post moratorium. The carrying costs the IESO pays to the Trust will be added to the IESO's regulatory variance account, which specified consumers have the ultimate obligation to bear. Similarly, the CEAs that the IESO will be remitting to the Trust is the ultimate obligation of the specified consumers. Management also considered the above-noted facts to determine whether it constitutes a contract per the definitions in IAS 32. Professional judgement is required given these considerations and management concludes that the IESO is performing a limited servicing function for the Trust, and that the specified consumers will be the source of the cash for which the Trust is entitled to (whether it is the carrying costs that the IESO will pay during the moratorium or the CEAs that are direct remittances from specified consumers). Accordingly, criterion c(i) is not applicable.

(d) *A contract that will or may be settled in the entity's own equity instruments and is:*

(i) *A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or*

(ii) *A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.*

**Not applicable.** The GA deferral asset will not be settled in the Trust's own equity instruments.

**<u>Conclusion:</u>**

Based on the assessment of the criteria for a financial asset classification, OPG concludes that the GA deferral asset is not a financial asset. OPG also concludes that the GA deferral asset is not a regulatory asset, since the Trust is not a rate-regulated operation.

***IFRS Guidance:***

*IAS 38 – Intangible Assets*

***Accounting Discussions:***

**1) Can OPG recognize the GA deferral asset as an intangible asset?**

**2) What is the appropriate amortization method for the intangible GA deferral asset?**

***Analysis:***

**1) Can OPG recognize the GA deferral asset as an intangible asset?**

Relevant Guidance

***IAS 38, paragraph 8:*** *An intangible asset is an identifiable non-monetary asset without physical substance.*

***IAS 38, paragraph 8:***

*An asset is a resource:*

*(a) controlled by an entity as a result of past events; and*

*(b) from which future economic benefits are expected to flow to the entity.*

***IAS 38, paragraph 12:***

*An asset is identifiable if it either:*

*(a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or*

*(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.*

***IAS 38, paragraph 18:*** *The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:*

*(a) the definition of an intangible asset (see paragraphs 8–17); and*

*(b) the recognition criteria (see paragraphs 21–23).*

*This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service i*t.

***IAS 38, paragraph 21:***

*An intangible asset shall be recognised if, and only if:*

*(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and*

*(b) the cost of the asset can be measured reliably.*

The Fair Hydro Act stipulates the following:

*Excerpt from Part VI, Section 29(1):*

*The investment asset constitutes a current and irrevocable property right and interest consisting, collectively, of the following rights and interests of the 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, the IESO and other prescribed parties;…*

*Part III, Section 16(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.*

*Part III, Section 17(6):*

*Each electricity vendor shall remit amounts in respect of the clean energy adjustment to the IESO for the benefit of the investment interest owners in accordance with the regulations.*

*Part III, Section 13(1):*

*Upon receipt of an invoice from an electricity vendor that includes an amount in respect of the clean energy adjustment, a specified consumer shall pay the amount to the electricity vendor as an agent of the investment interest owners.*

Analysis

The GA deferral asset, designated as an "investment asset" under the Act, is a right to collect, among other things, future cash flow streams representing:

- Principal payments on the related debt tranche issued;
- Interest on the related debt tranche issued;
- Reimbursable costs and expenditures paid or payable during the period, including those incurred by OPG as FSM on behalf of the Trust as stipulated in sections 10.2(3) and 10.13(3) of *Ontario Regulation 206/17* General (General Regulation); and
- OPG's fees as FSM paid or payable during the period which is comprised of both base and variable components, the calculations for which are stipulated in the General Regulation.

The right to collect the aforementioned cash flow streams from future specified creditors meets the definition of an intangible asset given:

- The GA deferral asset lacks physical substance
- The GA deferral asset is a resource controlled by OPG, as Financial Services Manager (FSM) of the Trust, as a result of purchasing specified portions of the GA deferral asset for cash payment when it is periodically offered for sale by the Independent Electricity System Operator (IESO)
- Its future economic benefits are expected to flow to OPG via the clean energy adjustment (CEA) payments specified consumers are expected to make, outlined in the above excerpts from the Act
- The GA deferral asset is capable of being separated from OPG as OPG has the ability to offer the asset or portions of it for sale to unrelated third parties, should it choose to do so
- The GA deferral asset arises from OPG's legal rights to receive payments from future specified creditors via the CEA applied to their electricity bills, as outlined in the above excerpts from the Act

The right to collect from future specified creditors meets the recognition criteria for an intangible asset given:

- It is probable that the expected future economic benefits attributable to the GA deferral asset will flow to OPG given there will always be specified consumers in Ontario, which the Act requires to make CEA payments when invoiced by their electricity vendors
- The cost of the GA deferral asset can be measured reliably as each specified portion will be purchased from the IESO with cash proceeds

OPG will not recognize increases in the value of the intangible asset for the interest component of the funding provided to the IESO in advance of a right to receive the interest component in cash under the legislation because an intangible asset cannot be accreted. Further, there is no cost associated with the interest component in advance of it being paid by the IESO to OPG.

The management fee component earned will also not be recorded as an intangible asset as it represents a return for services provided to the Trust rather than an intangible asset.

Given that an intangible asset cannot be accreted, the interest component will be recorded as income only when it is receivable from the IESO (see discussion below). The management fee component will be earned by OPG as the FSM and will be recorded as revenue when the criteria for revenue recognition as outlined in *IFRS 15 – Revenue from Contracts with Customer*s is met (see analysis below).

**Conclusion**:

Based on the considerations above, OPG concludes that the right to collect from future specified consumers will be accounted for as an intangible asset under IFRS. Management notes that professional judgement was exercised in the classification of the asset as an intangible, as the asset has very similar characteristics to a financial asset other than the fact that there is no specific entity that can be definitively identified as the counterparty. Per the considerations above, the eventual counterparty is the pool of specified consumers in Ontario, and management believes this weighs heavily in favour of an **intangible asset** classification.

OPG will recognize an intangible asset for the portion of the GA deferral asset related to future cash streams associated with **principal amounts only**.

**2) What is the appropriate amortization method for the intangible GA deferral asset?**

Relevant Guidance

***IAS 38, paragraph 97:*** *The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.*

***IAS 38, paragraph 98:*** *A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.*

***IAS 38, paragraph 98A:*** *There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:*

*(a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or*

*(b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.*

***Excerpt of IAS 38, paragraph 98C**: In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation… In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined.*

<u>Analysis</u>

The intangible asset related to the right to collect from future specified consumers via the IESO is expected to accumulate until about 2030. This period of time is in line with the borrowing requirements to finance the program. The Act stipulates that the IESO cannot start collecting CEAs from specified consumers before May 1, 2021 and collection will continue until all funding obligations incurred by the Trust have been repaid in full. The Act contemplates that the reference periods will end on April 30, 2047 (or a later day, if prescribed).

Given the above information, it is anticipated that the intangible asset will have a finite life, determined as the period of time required to recover the amounts from specified consumers to repay all outstanding funding obligations. In considering the appropriate amortization method, management determined any predominant limiting factors inherent in the intangible asset. Management identified that such limiting factors in this arrangement relates to the timing of the collection of the CEAs. Specifically, the CEAs which specified consumers will repay after May 1, 2021, represents the “revenue” the Trust stands to earn, and its collection retires or draws down the intangible GA deferral asset. In line with guidance from IAS 32 paragraph 98C, the predominant limiting factor inherent in the GA deferral asset is the collection of CEAs or “revenue” from specified consumers, and therefore, the timing of collection is an appropriate basis for amortization.

**<u>Conclusion</u>**: The Trust will have a defined period over which the intangible GA deferral asset will be available for use, starting when the CEAs are being repaid by specified consumers until all funding obligations incurred by the Trust are paid in full. The amortization method can be directly linked to revenues (i.e. the collection period of the CEAs), which will be used as the unit of measure for the amortization rate under the unit of production (consumption) method.

**<u>Differences from US GAAP:</u>** Under US GAAP, this asset is treated as a financial asset, instead of an intangible asset. There is a difference in classification for the following reasons:

- US GAAP has a concept on structured financial assets and there is no equivalent concept under IFRS
- The considerations to determine whether an arrangement is a contract or not under IAS 32 *Financial Instruments* requires professional judgement. OPG’s conclusion under US GAAP is that the Trust has a contract with the IESO following the application of the financial asset guidance, whereas under IFRS, in the absence of similar guidance, it was concluded that the contract is with the pool of specified consumers that bear the ultimate responsibility to pay for the CEAs. Not having a contractual right to cash flows from a specific entity precludes the classification of a financial asset under IFRS.
- Under IFRS, regulatory arrangements such as the financing of the GA deferral are not recognized as financial assets.

- Under IFRS, there is a general conceptual concept that any assets that do not fall within the scope/definition of any other asset, is considered an intangible asset. This further supports OPG's classification conclusion of the GA deferral asset as an intangible asset, given that management exercised some professional judgement in its consideration of the financial asset classification as the criteria did not easily 'fit' the asset.

There will be differences between the asset balances under both standards because the Financial Asset will be recorded at amortized cost under US GAAP and the Intangible Asset is recorded at cost under IFRS. However, such differences will be limited to minor timing differences.

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**B. How should revenue/income and expenses related to the GA deferral asset be accounted for?**

***Accounting Discussions:***

1) **How should the Trust account for the different cash flow streams it will receive from the IESO?**
2) **How should OPG account for receipts from the Trust relating to management fee income, interest income on its subordinated debt investment in the Trust, and third-party expenses incurred on behalf of the Trust?**
3) **Are the carrying costs provided by the IESO during moratorium financial assets?**

<u>Relevant Guidance:</u>

IFRS 15 – Revenue from Contracts with Customers

***Accounting Discussions:***

1) **How should the Trust account for the different cash flow streams it will receive from the IESO?**

**<u>Pre-funding of carrying costs/CEAs and resulting interest income</u>**

As noted above, the Trust expects to receive pre-funding from the IESO related to carrying costs/CEAs ahead of when the underlying obligations become due. This is because the Trust will not have funds available at inception to meet its obligations, so the MTSA requires the IESO to pre-fund the Trust's carrying costs, which includes interest costs. If the forecasted expenses do not occur in the following month or the amount differs, the Trust will true up its request to the IESO for the following month, per the MTSA.

To effect the transaction, on or before the 4th business day of each month, the Trust will prepare and deliver to the IESO a written statement (substantially in the form of Exhibit C, Monthly Carrying Costs Statement per the MTSA) certifying the amount of the carrying costs expected to be incurred in the following calendar month. The IESO will then provide the funds to the Trust via wire transfer on or before the 14th business day following the IESO's receipt of the Monthly Carrying Costs Statement (i.e. around the third week of the month).

It is expected that the cash in the bank account will attract some interest, especially in months before an interest payment is due or before a debt issuance as interest expense and agency fees are larger expenses. Interest income will accrue and be credited to the Trust from the time cash is received to the end of the month when the bank credits the account. According to section 7.03(e) of the MTI, "*all interest and earnings (net of losses and investment expenses), if any, on funds credited to an Issuer Account will be part of that Issuer Account*". The cash available from interest income or other investment income will be left in the account until required to pay for other carrying costs in accordance with the payment waterfall per section 7.04 of the MTI. In practice, this means that the Trust will request less money from the IESO in the next month's carrying costs statement equivalent to the available cash. There is no "customer" from whom the interest income is received and it is not representative of consideration earned in exchange for an output of the Trust's ordinary activities. Therefore, management is of the view that interest income earned is not within the scope of IFRS 15 paragraph 6 which states (emphasis added):

> *"An entity shall apply this Standard to a contract (other than a contract listed in paragraph 5) <u>only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration</u>. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities."*

**<u>Conclusion</u>**:

Management believes that when the Trust receives the pre-funding, it will have a liability as the funds are being advanced for the following month's forecast expenses, and will record such receipts in the "Advances from the IESO" liability account. As each obligation that was forecasted is settled, the Advances from the IESO account will be reduced and the expense will be accrued/revenue will be recognized.

The Trust will be entitled to recognize interest income on its bank balances as time passes, in particular at the end of the month when the accounts are credited. Accordingly, the Trust will recognize interest income at the end of each month.

**<u>Principal versus Agent Guidance for OPG's management fees, Trust-incurred expenses, and OPG-incurred expenses</u>**

An analysis to determine who the principal or agent is required because there is a close relationship between OPG and the Trust in providing various services to the customer, the IESO. Additionally, management also expects the transfer of funds between the Trust and OPG for certain cash flow streams as the IESO will only be remitting all monies to the Trust per the MTSA. The analysis below will determine the Trust's role for the following cash flow streams:

- OPG's management fees
- Trust-incurred third party costs
- OPG-incurred third party costs

<u>Relevant Guidance</u>

***IFRS 15, paragraph B35*** (emphasis added):

*"An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. <u>However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer</u>. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf"*

***IFRS 15, paragraph B35A*** (emphasis added):

*When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of **<u>any one</u>** of the following:*

*a) a good or another asset from the other party that it then transfers to the customer.*

*b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.*

*c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.*

***IFRS 15, paragraph B36:***

*"An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party."*

***IFRS 15, paragraph B37:***

*Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:*

*(a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.*

*(b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.*

*(c) the entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.*

**<u>OPG's management fees</u>**

The monies received from the IESO relating to management fees is a revenue transaction as there are promised services arising out of the Act for OPG to be the FSM, therefore, the criteria for principal versus agent will be assessed to determine if the Trust is the principal or agent given that the fees flow through the Trust. This analysis was performed mainly for presentation purposes, as OPG concluded in the discussion below under the subheading "Exclusion of OPG's management fees and Trust's remuneration in 5-Step analysis" that management fees are expected not to be relatively material in dollar terms. Refer to the analysis below for more details.

**Specified good/service**: Ongoing management of the Trust and its debt portfolio as well as the related activities for raising external financing.

**Control assessment**:

IFRS 15, paragraph B35A

a) **Not applicable** – The Trust does not obtain control of any good or another asset from OPG that it then transfers to the IESO in relation to the management fee (i.e. OPG performs the services directly without going through the Trust).

b) **Not applicable** – OPG as FSM is obligated to provide ongoing services to the Trust per the Management Agreement in exchange for the management fees it will receive. Therefore, the Trust technically obtains a right to such service from OPG per the criterion. However, further guidance outlined in IFRS 15, paragraph B35 (see above excerpt) stipulates that having only a momentary control of the legal right to the service before it is transferred to the customer does not necessarily mean that the Trust controls the service.

c) **Not applicable**. The Trust does not have any additional input into the promised service for the IESO.

IFRS 15, paragraph B37

a) **Not applicable** – only OPG provides the specified services and is responsible for satisfactory performance under the Management Agreement.

b) **Not applicable** – the Trust has no inventory risk before or after the transfer of services to the IESO.

c) **Not applicable** – the Trust did not participate in any way in the determination of the management fees.

**Conclusion**:

Based on the criteria assessed above, management concludes that the Trust is acting as an agent for OPG in the performance of the specified services related to earning management fees (i.e. ongoing management of the Trust/its debt portfolio and raising external financing).

As an agent, the Trust will recognize monies it receives from the IESO relating to OPG's management fees on a net basis. Specifically, the Trust can record management fee revenue net of the related expenses which is the amount paid to OPG, resulting in a net income statement impact of nil. This is consistent with the flow through nature of the cash and revenues in the Trust (i.e. the Trust receives cash for OPG's management fee revenue and immediately remits the same to OPG).

**Trust-incurred third party costs**

The Trust is expected to incur third-party costs related to its promised services to the IESO to finance the GA deferrals. Such costs may include agency fees, trustee fees, legal and audit fees, etc. As noted above, the Trust expects to receive pre-funding from the IESO related to third-party expenses it will incur the following month and recording the amount as "Advances from IESO" liability account (refer to the "Pre-funding of carrying costs/CEAs and resulting interest income" for further discussion). This is because the Trust will not have funds available at inception to meet its obligations, so the MTSA requires the IESO to pre-fund the Trust's carrying costs, which includes third-party expenses it will incur. These costs will not be submitted to the OEB for its review, unlike the OPG-incurred expenses discussed below. As OPG is also involved in the management and administration of the Trust in its capacity as FSM, the principal versus agent considerations will be assessed to determine if the Trust is the principal or the agent for the promised service.

In relation to the costs pertaining to debt issuance, such costs will be accounted for in line with IFRS 9 paragraph 5.1.1, where debt issuance costs are not included in the fair value of the debt.

**Specified good/service**: Engaging the appropriate third-party service provider to facilitate the financing activities of the Trust.

**Control assessment**:

IFRS 15, paragraph B35A

a) **Not applicable** – The Trust does not obtain control of any good or another asset from OPG that it then transfers to the IESO in relation to the specified service.

b) **Not applicable** – OPG as FSM is obligated to provide management and administration service to the Trust per the Management Agreement in exchange for the base management fees it will receive. As part of its duty as manager, OPG will engage and retain the appropriate third-party service provider (e.g. legal counsel, trustees, auditors, etc.), as required, to enable the Trust to facilitate its business objective. The Trust is able to direct OPG's services on its behalf for the benefit of the financing arrangement with the IESO. However, similar to management's view on OPG's management fees above, further guidance outlined in IFRS 15, paragraph B35 (see above excerpt) stipulates that having only a momentary control of the legal right to the service before it is transferred to the customer does not necessarily mean that the Trust controls the service. OPG will undertake the necessary steps to satisfy the performance obligation but control of the services by the Trust is momentary and the benefit flows through to the IESO.

c) **Not applicable**. The Trust does not have any additional input into the promised service for the IESO.

IFRS 15, paragraph B37

a) **Applicable** – The Trust has the ultimate responsibility for financing the GA deferral by issuing debt. OPG, as FSM, will not be liable for any part of the Trust's outstanding debt under any circumstance.

b) **Not applicable** – the Trust has no inventory risk before or after the transfer of services to the IESO.

c) **Not applicable** – OPG as FSM will negotiate all the Trust agreements, which includes the determination of the price of third party services.

**Conclusion**:

Management concludes that the Trust is the principal given it has the ultimate responsibility to finance the GA deferral. As the principal, the Trust will recognize monies it will receive from the IESO relating to its own third-party expenses on a gross basis. Specifically, the Trust will recognize cost recovery revenue as well as the related third party expenses and present these separately on the face of the income statement.

As the Trust will be getting pre-funding from the IESO through the monthly carrying costs remittance process, any amount related to third-party costs will be allocated as such, with the offset to the Advances from IESO liability account. The cost recovery revenue will be realized as the expense is incurred. As the liability is settled, trade payables and cash will be reduced accordingly.

**OPG-incurred third party costs**

OPG is expected to incur third-party costs on behalf of the Trust related to the Fair Hydro Plan. Such costs may include agency fees, trustee fees, legal and audit fees, etc. This type of transaction is very similar to the Trust-incurred third party expenses, with the following differences:

- OPG will incur these costs and will not be reimbursed until the following year per the timeline set out in the General Regulation, and

- OPG's expenses will be subject to the OEB's review per the General Regulation. In particular, an external auditor's report will be required to accompany the fee and expenses submission to ascertain the accuracy of the expense, that it was incurred by OPG, and they were paid to third-parties. Accordingly, these costs will not be subject to pre-funding by the IESO, it will be reimbursed once approved.

**Specified good/service**: Engaging the appropriate third-party service provider to facilitate the financing activities of the Trust, settling the resulting liabilities, and seeking recovery from the OEB.

**Control assessment**:

<u>IFRS 15, paragraph B35A</u>

a) **Not applicable** – The Trust does not obtain control of any good or another asset from OPG that it then transfers to the IESO in relation to the specified service.

b) **Not applicable** – OPG as FSM is obligated to provide management and administration service to the Trust per the Management Agreement in exchange for the base management fees it will receive. As part of its duty as manager, OPG will engage and retain the appropriate third-party service provider (e.g. legal counsel, trustees, auditors, etc.), as required, to enable the Trust to facilitate its business objective. The Trust is able to direct OPG's services on its behalf for the benefit of the financing arrangement with the IESO. However, similar to management's view on OPG's management fees above, further guidance outlined in IFRS 15, paragraph B35 (see above excerpt) stipulates that having only a momentary control of the legal right to the service before it is transferred to the customer does not necessarily mean that the Trust controls the service. OPG will undertake the necessary steps to satisfy the performance obligation but control of the services by the Trust is momentary and the benefit flows through to the IESO.

c) **Not applicable**. The Trust does not have any additional input into the promised service for the IESO.

<u>IFRS 15, paragraph B37</u>

a) **Not applicable** – Per the Management Agreement, OPG is primarily responsible for administration and management of the financing arrangement with the IESO, which is the basis for the specified services relating to third-party costs.

b) **Not applicable** – the Trust has no inventory risk before or after the transfer of services to the IESO. However, OPG will have some collection risk, as the costs it incurs will be subject to an external auditor conducting specified procedures over the accuracy and incurrence of such costs before the OEB approves such costs for reimbursement.

c) **Not applicable** – OPG as FSM will negotiate all the Trust agreements, which includes the determination of the price of third party services.

**<u>Conclusion</u>**:

Management concludes that the Trust is the agent for this specified service. As the agent, the Trust will recognize monies it will receive from the IESO relating to OPG's third-party costs on a net basis. Specifically, the Trust will net out the expense with the contra expense account in the income statement, for a net impact of nil.

This conclusion aligns with the following Transition Resource Group for Revenue Recognition guidance which indicates that amounts collected on behalf of third parties (i.e. OPG) would not be included as consideration, and is not revenue for that entity (i.e. Trust). Specifically, it indicates (emphasis added):

> *"… the standards require that any "amounts collected on behalf of third parties (for example, some sales taxes)" be excluded from the transaction price.*
>
> ***How would entities determine the presentation of amounts billed to customers (e.g., shipping and handling, reimbursement of out-of-pocket expenses and taxes)***

> ***under the standards (i.e., as revenue or as a reduction of costs)? [TRG meeting 18 July 2014 – Staff paper no. 2]***
>
> *TRG members generally agreed that the standards are clear that any amounts not collected on behalf of third parties would be included in the transaction price (i.e., revenue). That is, if the amounts were incurred by the entity in fulfilling its performance obligations, the amounts will be included in the transaction price and recorded as revenue."*

**Receipt of Principal and Interest Income under the 5-Step Model**

The financing arrangement between the Trust and the IESO for the GA deferral asset is not a widely used concept of financing in Canada, however, OPG is aware of similar transactions in the United States using rate reduction bonds. In addition, the accounting for the arrangement is also unusual as noted in the asset classification conclusion above. The intangible GA deferral asset have similar characteristics to a financial asset, but primarily differs in substance because there is no specific entity as its counterparty (i.e. the Ontario electricity market's future specified consumers is a pool of counterparties). Further, the related revenue streams the Trust expects to receive from the IESO is atypical and passive in nature.

For the revenue related analyses below, they will be assessed against the new revenue standard *IFRS 15 – Revenue from Contracts with Customers* given that it will be effective January 1, 2018. IFRS 15 identifies arrangements that are to be accounted for as revenue. From the Trust's perspective, following cash flows from the IESO are revenue related:

- OPG's management fees and the Trust's remuneration
- Repayment of the principal of the GA deferral asset
- Interest income

Exclusion of OPG's management fees and Trust's remuneration in 5-Step analysis

The monies the Trust will receive from the IESO relating to management fees is a revenue transaction as there are promised services arising out of the Act for OPG as FSM. However, because the IESO will only pay the Trust directly, the consideration for OPG's services pass through the Trust, which the Trust then remits to OPG.

For OPG's management fees as FSM, the specified consumers are ultimately obligated to pay the CEAs, which will include OPG's management fees (per section 19(3) of the Act). The IESO will be acting as an agent to facilitate the payment between the Trust and the specified consumers. Accordingly, management concludes that OPG's fees as FSM should be accounted for as revenue under IFRS 15 as OPG is providing a service for which specified consumers provide consideration (through CEAs) as 'customers'.

Management expects that the dollar amount of the fees OPG will earn from its role as FSM will not be material relative to OPG's financial reporting thresholds. The estimate of the range for the base management fee is $1 million and will peak at $11 million at year 2029. Compared to OPG's generation revenues of over $5 billion in 2016, this amount is relatively not material. In addition, the variable fee is capped at ± 2% of 5% applied to the sum of the senior debt issuances in the year (i.e. 51% of the total debt). Under the current Fair Allocation Amount underpinning OPG's Financing Plan, the expected total annual borrowing ranges from approximately $900 million to $2.8 billion. These forecast amounts would translate to variable fees of approximately ± $500 thousand to ± $1.4 million, which are not material amounts relative to OPG's financial reporting thresholds.

While the dollar amount of fees is considered to be not material relative to OPG's financial reporting thresholds, the percentage of the amount-at-risk is considered to be meaningful for the purposes of OPG's consolidation of the Trust, as discussed in the consolidation memo entitled "Consolidation Considerations of the Fair Hydro Trust Under US GAAP". Accordingly, an analysis under IFRS 15 revenue recognition 5-step model was not included in the discussion. Only the receipt of principal for the GA deferral asset and interest income were analysed under IFRS 15 below.

Using the same rationale, OPG did not include any revenue analysis for the compensation of the Trust. In particular, the Trust is entitled to remuneration from OPG in the amount of $10/month (exclusive of any applicable sales taxes) in accordance with section 5.5 of the Management Agreement. The remuneration is consideration for the Trust for engaging in activities contemplated by the Act. As noted, this amount is nominal and no further analysis was performed. The Trust will recognize gross revenue on a monthly basis as cash is received from OPG.

Customer in the GA deferral asset financing arrangement

According to IFRS 15, paragraph 6, "*A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration."*

Similar to the US GAAP analysis, the customer in this transaction is primarily the IESO, with the specified consumers being a 'second' entity or counterparty to the contract. Refer to US GAAP memo for analysis.

**Difference from US GAAP:** Due to the difference in the asset's classification, there is a slight difference in the characterization as follows:

- US GAAP – financial asset classification – counterparty for the financial asset is the IESO
- IFRS – intangible asset classification – customer of the revenue transaction is the IESO

Revenue Recognition Analysis

The following 5-step model will be considered in analyzing the revenue streams relating to the repayment of the GA deferral asset and interest income.

- Step 1 – Identify the contract(s) with a customer
- Step 2 – Identify the performance obligations in the contract
- Step 3 – Determine the transaction price
- Step 4 – Allocate the transaction price to the performance obligations in the contract
- Step 5 – Recognizing revenue when (or as) performance obligations are satisfied

**Step 1 – Identify the contract(s) with customer**

Excerpt from ***IFRS 15, paragraph 9*** (emphasis added)*:*

*An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:*

1. *The parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;*
2. *The entity can identify each party's rights regarding the goods or services to be transferred;*
3. *The entity can identify the payment terms for the goods or services to be transferred;*
4. *The contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and*
5. *It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.*

Analysis

The recovery rights related to the repayment of the GA deferral asset principal and interest income arise from the Fair Hydro Act and confers to the holder of the asset rights to future cash flows from the IESO for carrying costs during the moratorium period (for interest income only) and rights to CEAs payable by specified consumers (for both principal and interest income). The mechanics of the recovery and remittance of the related amounts by the IESO are outlined in the Master Transfer and Servicing Agreement (MTSA). Therefore, the 'contract' is founded under both statutory and contractual rights.

The Trust's financing activities has the characteristics per the above-noted criteria as follows:

**1.** GA deferral asset: The purchase of the intangible asset from the IESO is governed by the terms in MTSA between the IESO and the Trust. This contract will be approved by both parties in writing.

   Interest income: The 'contract' is legislated by the Act, specifically *Part III, Section 16(4)*, which received Royal Asset in June 2017. The Act establishes the rights and obligations of OPG as the FSM, the IESO as servicer, and the specified consumers with respect to interest earned on the GA deferral asset.

**2.** GA deferral asset: The Act details OPG's rights regarding the intangible GA deferral asset it intends to acquire, the IESO's rights regarding the Regulatory Asset it plans to offer for sale, and the ultimate collection of the CEAs, which represent the cash flow streams from future specified consumers.

   Interest income: Section 16(4) of the Act outlines the Trust's right to earn interest on the financing amounts it provides to the IESO for the purchase of the GA deferral asset.

**3.** GA deferral asset: The payment terms for the intangible GA deferral asset OPG intends to acquire from the IESO are outlined in the MTSA, which states that if all requisite conditions have been satisfied, OPG will wire transfer the transaction price/consideration to the IESO at the agreed upon closing date.

   Interest income: The interest income earned on the financing amounts the Trust provides to the IESO will be included as part of the carrying costs during the moratorium period and as part of CEAs after the moratorium period. Section 25(3) of the Act stipulates that the IESO cannot collect the CEAs from specified consumers before May 1, 2021. During the period from December 1, 2017 to July 31, 2021 the IESO will pay the monthly carrying costs of the Trust (including the interest income) pursuant to Section 9.1(1) of the General Regulation.

**4.** GA deferral asset/ Interest income: The above arrangement will change the cash flows for OPG in its role as FSM, the IESO and the Trust as a result of:

   - The cash expended to purchase the GA deferral asset
   - The interest income received by the Trust from the IESO

**5.** GA deferral asset/ Interest income: It is probable that the Trust will collect the consideration to which it is entitled to from the specified consumers, via carrying costs that the IESO will pay on behalf of specified consumers during moratorium and via CEAs the IESO will collect and remit to the Trust. Given electricity is a basic need and specified consumers are always expected to be present in Ontario, the expected credit risk is minimal.

**Step 1 Conclusion**:

All of the criteria under Step 1 for identifying the contract (arrangement) has been met. Therefore, the revenue streams embedded in the contract with the IESO for the financing of the GA deferral asset will be accounted for under IFRS 15 (i.e. repayment of the GA deferral asset/principal and interest income).

**Step 2 – Identify the performance obligations in the contract**

***IFRS 15, paragraph 22***:

*At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:*

*(a) a good or service (or a bundle of goods or services) that is distinct; or*

*(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).*

**Sub-criterion (b) is applicable.** As it relates to the repayment of the underlying principal for the GA deferral asset and interest income, management is of the view that the promised service represents a series of distinct services because both cash flow streams result from a single performance obligation – the Trust providing the financing services for the GA deferral asset. Provided that the Trust continues to finance the GA deferral asset, it will be entitled to repayment of principal and interest income as stipulated by both the Act and the MTSA.

OPG as FSM under the legislation and as manager under the management agreement is tasked with the continuous performance obligation to provide management services to the Trust, which then allows the Trust provide the finance the GA deferral asset, which represents the same pattern of transfer (i.e. continuous).

**Step 2 Conclusion:**

There is one single series of performance obligation that results in the entitlements relating to principal and interest income: the Trust providing the financing services for the GA deferral asset.

**Step 3 – Determine the transaction price**

***IFRS 15, paragraph 47:***

*An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.*

***IFRS 15, paragraph 50:***

*If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.*

***IFRS 15, paragraph 53:***

*An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:*

*a. The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.*
*b. The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).*

Analysis

As previously noted, the consideration for the receipt of principal for the GA deferral asset, will be made by specified consumers through the repayment of CEAs per the Act, while consideration for interest income will be made by the IESO through payments of carrying costs during the moratorium period per the General Regulation and through CEAs after the moratorium period per the Act.

OPG believes that the interest portion of the carrying costs and CEAs will represent variable consideration because the amount of revenues will be contingent on future decisions to refinance or not. Specifically, the amount of consideration will not be known at the date when underlying debt is issued as interest will be a factor of any future refinancing decisions. Accordingly, IFRS 15 paragraph 50, requires that the Trust estimate these variable considerations.

For the receipt of principal in the CEAs, management believes that the consideration is fixed, even though there are risk of payment default or delays from some specified consumers. The true up mechanism will address any such payment default issues for both the interest and principal portions of the CEAs. Management expects that there will be no such issues during the moratorium as IESO will be paying the full carrying costs of the Trust including interest payments. Post moratorium, if the full amount of CEAs is not collected, the payment waterfall outlined in section 7.04 (e) of the MTI will be followed for the allocation of the monies collected. However, the true up mechanism ensures that the Trust is made whole, by including any portion of unpaid CEAs in the next reference period CEAs. This mechanism supports why management believes that the consideration related to principal is fixed.

*Estimate of Interest Income*

The carrying costs the Trust will receive from the IESO are expected to vary every month as these will represent forecast costs for the following month, and could include interest expense for total debt outstanding (timing is dependent on when interest payments are due). Pursuant to section 3.14 of the MTSA, the Trust will be required to prepare a monthly carrying costs statement to inform the IESO of the forecast expenditures for the following month.

To estimate the consideration related to interest, OPG will calculate the value equivalent to the debt outstanding multiplied by the applicable coupon interest rate (applied on a by-tranche basis). The product will represent the interest expense payable on the outstanding debt balance that the Trust will remit to bondholders and is the variable consideration for the following month related to interest.

*Determination of Principal Amounts*

For the CEAs, the calculation is made for each 6-month period pursuant to section 15(1) of the Act and will be equivalent to the sum of the estimated finance amounts plus the true up amount for the reference period, divided by the number of months in the reference period (i.e. six-month period beginning November 1, 2017 and ending on either April 30, 2047 or a later day as may be prescribed). Per section 7(2) of the General Regulation, OPG as FSM is required to notify the Ontario Energy Board (OEB) of the CEAs for a reference period as follows:

a) in the case of a reference period that begins on May 1 – on or before April 1 in the same year; and
b) in the case of a reference period that begins on November 1 – on or before October 1 in the same year.

Section 15(2) of the Act specifies that the true up amount for each reference period should take into account historical and reasonably foreseeable differences between the estimated and actual finance amounts, differences from factors such as taxes, consumer defaults and delays, billing lags and write-offs, as well as variations in the consumption of electricity. For the estimate of the consideration related to repayment of principal, OPG will use the estimate included in the Financing Plan (and also included in the estimate of the CEAs submitted to the OEB), which is based off the Fair Allocation Amount. Under the current version of the Financing Plan, it is expected that CEAs will include portions of principal for the underlying debt at around year 2030 (per Figure 2).

**Step 3 Conclusion**:

Given the considerations noted, management concludes that the appropriate transaction prices for the series of performance obligation are as follows:

- Interest portion of carrying costs and CEAs – variable consideration as estimated by OPG as FSM.

- Principal portion of CEAs – fixed consideration as calculated by OPG as FSM.

Based on how the carrying costs and the CEAs are calculated and derived, management believes that the "expected value" approach will better predict the amount of variable consideration the Trust will be entitled to for interest payments.

**<u>Step 4 – Allocating the transaction price to the performance obligations in the contract</u>**

***IFRS 15, paragraph 73:***

*The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.*

***<u>IFRS 15, paragraph 76</u>***

*To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.*

As indicated under Step 1, management has previously concluded that the provision of financing services represents a series of distinct series. The fixed consideration is therefore allocated entirely to the performance obligation of financing services. The appropriate pattern of transfer is discussed in Step 5.

As noted in step 3 above, the interest portion of carrying costs and CEAs are variable consideration and requires to be estimated. The analysis is as follows:

***IFRS 15, paragraph 85:***

*An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) if both of the following criteria are met:*

*a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and*

**Met**. Section 3 of the Act stipulates that the purposes of the Fair Hydro Plan are to (1) recognize clean energy benefits have accrued and will accrue over time and will continue to benefit present and future electricity consumers in Ontario and (2) ensure that clean energy costs and clean energy benefits are fairly allocated between present and future specified consumers. The Fair Allocation Amount was derived to achieve these purposes and is the foundation of OPG's Financing Plan for the GA deferral asset. Essentially, specified consumers of electricity in Ontario are getting the benefit of the deferred GA costs through the clean energy initiatives that the Province has invested in. Management views this as the outcome of the effort of the Trust's financing activities. The carrying costs and CEAs are structured so that they reflect the collection pattern intended in the Fair Allocation Amount.

*b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.*

**Met.** For the identified performance obligation of the GA deferral financing, the Trust expects to be entitled to the interest portion of the carrying costs (during moratorium) and the CEAs (post moratorium).

**Step 4 Conclusion:**

For the receipt of principal, the amount of the fixed consideration is the amount that OPG calculates and includes in the CEAs and will be allocated entirely to the one performance obligation of the financing the GA deferral asset.

For the variable consideration relating to interest income, the criteria in paragraph 85 were met, which indicates that the variable consideration for the interest portion of the carrying costs and the CEAs should be allocated entirely to each unit of the series of the performance obligation.

**Step 5 - Recognizing revenue when (or as) performance obligations are satisfied**

Relevant Guidance

***IFRS 15, paragraph 31:***

*An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.*

***IFRS 15, paragraph 32:***

*For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.*

***IFRS 15, paragraph 35:***

*An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:*

*(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);*

*(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or*

*(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).*

Excerpt from ***IFRS 15, paragraph 38:***

*If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time.*

***IFRS 15, paragraph B16:***

*As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognize revenue in the amount to which the entity has a right to invoice.*

Analysis

As noted in Step 1 above, the Trust providing financing for the GA deferral asset is the single series of performance obligation in the contract with the IESO. Management believes that both revenue streams relating to principal and interest income will be earned by the Trust in a manner consistent with the benefit received by the specified customers as the service is continuous. In particular:

- **Principal on underlying GA deferral asset** – As noted in Step 4 above, one of the purpose of the Fair Hydro Plan is to ensure that clean energy costs and clean energy benefits are fairly allocated between present and future specified consumers. The Fair

Allocation Amount was derived to achieve this purpose and is the foundation of OPG's Financing Plan for the GA deferral asset. Essentially, specified consumers of electricity in Ontario are getting the benefit of the deferred GA costs through the clean energy initiatives that the Province invested in. Management views this as the outcome of the effort of the Trust's financing activities. Given this consideration, management believes that the related revenue is earned over the financing program, essentially in the same pattern as the underlying principal repayment schedule embedded in the calculation of CEAs, which will be based off the Fair Allocation Amount. As noted, the Fair Allocation Amount was derived to allocate the clean energy costs with the clean energy benefits fairly among the specified consumers. The monthly CEAs recoverable when specified consumers start repaying the principal portion of the debt around the year 2030 will include a prorated portion of the principal for that 6-month reference period. The amortization of the intangible GA deferral asset will match the timing of when revenue related to principal is recognized as the consumption of that asset is based on the revenue stream (i.e. collection of CEAs).

- **Interest income** – The specified consumers benefits simultaneously when the Trust provides the IESO with financing through lower electricity bills and the presence and availability of clean energy infrastructure in the province. Therefore, interest income should be recognized over time as the benefits are also consumed over time. An objective period of measuring "over time" for interest income is monthly as it aligns with the remittance provisions in the MTSA.

**Step 5 Conclusion:**

- The repayment of the principal related to the GA deferral asset will be recognized in line with the principal portion of the CEAs. The revenue recognized will be consistent with the principal repayment in the Fair Allocation Amount.
- The interest income earned on the financing provided to the IESO will be recognized as revenue on a monthly basis at the end of the month from the commencement of the program (i.e. when the first debt is issued).

**Differences between IFRS and US GAAP on the Trust's records:**

| Timing | Timing of Recognition | | Measurement | |
|---|---|---|---|---|
| | IFRS | US GAAP | IFRS | US GAAP |
| **Receipt of Principal** | When CEAs are payable and includes principal portion (around year 2030) | When CEAs are repaid and includes principal portion (around year 2030) | Accrual basis recognized as revenue with offset to amortization expense of the intangible | Cash basis recognized as a decrease to the financial asset (no P&L impact) |
| **Interest** | Through passage of time, at the end of the month (monthly) | Through passage of time, at the end of the month (monthly) | Accrual basis calculated using the coupon interest rate applied to the outstanding debt | Calculated using the effective interest rate method applied to the financial asset |

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**2) How should OPG account for receipts from the Trust relating to management fee income, interest income on its subordinated debt investment in the Trust, and third-party expenses incurred on behalf of the Trust?**

**Management fee income**

As concluded under the heading "OPG's management fees" above, OPG is the principal in the specified service relating to the ongoing management of the Trust and its debt portfolio as well as the related activities for raising external financing. As the principal, OPG will record management fees received from the Trust on a gross basis, separately showing management fee revenue separately from the related expenses.

The specified consumers are ultimately obligated to pay the CEAs which will include OPG's management fees (per section 19(3) of the Act). The IESO will be facilitating the payment between the Trust and the specified consumers. Accordingly, management concludes that OPG's fees as FSM should be accounted for as revenue under IFRS 15.

As noted above, management expects that the fees OPG will earn from its role as FSM will not be material relative to OPG's financial reporting thresholds. Accordingly, an analysis was not included in the discussion.

**Interest income**

The interest income that OPG will earn is based on the outstanding amount of the subordinated debt in the Trust, which will represent around 49% of the total debt. The amount receivable by OPG is based on the stated coupon rate applied to each respective tranche (Tranches B to C) of funding issued to-date and the passage of time. Therefore, management is of the view that interest income earned by the OPG is not within the scope of IFRS 15.

**Conclusion**:

OPG owns the investment interest in the subordinated debt, therefore, it is entitled to recognize interest income as time passes. Accordingly, OPG will recognize interest income at the end of each month. As the Trust will be receiving pre-funding from the IESO for the Trust's interest expense, OPG can expect to receive cash for interest income when the underlying interest expense comes due. Because the Province's equity injection does not have an associated interest expense, OPG will effectively realize the full interest income on the Province's 44% contribution. OPG's subordinated debt investment will be earning the difference between its cost of the funds and the interest rate it will be charging the Trust.

**OPG-incurred third-party expenses**

As concluded above, OPG is the principal in relation to specified services related to engaging the appropriate third-party service provider to facilitate the financing activities of the Trust, settling the resulting liabilities, and seeking recovery from the OEB. Accordingly, it will report recoveries on a gross basis.

As the reimbursement of these costs are subject to OPG's annual review at the beginning of the following year in which the expenses relate, OPG will not get cash until the OEB's review is completed. In particular, the total of the previous year's expenses will be reimbursed as a lump sum payment in the following year.

For third-party expenses OPG will incur related to the Fair Hydro Plan, OPG's expense account related to Fair Hydro will be debited with a corresponding entry to cash or payable when the obligation arises. At the same time, management believes that the criteria for an asset recognition will be satisfied when OPG is invoiced by the third-party. Specifically, the receivable:

- Will represent probable future economic benefits to OPG as the IESO is legislatively obligated to reimburse such costs to the Trust, which the Trust then remits to OPG (subject to the OEB's review per the General Regulation noted above), and
- Results from a past transaction.

Management believes that the OEB's review of OPG-incurred third-party costs is perfunctory in nature and is not the appropriate trigger for OPG to be able to recognize any unbilled revenue (asset) and the related cost recovery revenue.

**Conclusion**:

OPG will recognize an unbilled revenue from the Trust, with a corresponding increase to cost recovery revenue when the third-party invoices OPG. At this point, management believes that it has earned a right to an asset. The balance of the unbilled revenue asset account will be transferred to a receivable account once OPG invoices the Trust at year end.

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### 3) Are the carrying costs provided by the IESO during moratorium financial assets?

As discussed above, the Act mandates that no amounts recorded by the IESO in the variance account can be collected from specified consumers through CEAs before May 1, 2021 (the moratorium period). CEAs represent the carrying costs of the Trust (which is the sum of: interests, derivative payments, reserve account deposits, costs and expenditures for the period, and tax liabilities less the sum of: reserve account withdrawals, payments from derivative agreements, and tax refunds) plus principal and true up amounts. CEA payments will continue until all debt issued by the Trust is repaid.

Therefore, Section 9.1 (1) of the General Regulation stipulates that the IESO will pay for the carrying costs of the Trust during the period from December 1, 2017 to July 31, 2021. These costs are added directly to the variance account (per section 16, paragraph 3 of the General Regulation) which forms the IESO's regulatory asset.

OPG's assessment is that the payments made by the IESO to the Trust during the moratorium are not financial assets for the following reasons:

- The obligation by the IESO to pay for the Trust's carrying costs during the moratorium period is a statutory obligation stipulated in the General Regulation under section 9.1(1). Ultimately, the carrying costs (like the CEAs) is the statutory obligation of specified consumers as stipulated in section 13(1) of the Act and not the IESO. Therefore, the Trust is getting compensated by the specified consumers, through the IESO.
- On behalf of the owners of the GA deferral assets, the IESO will facilitate the monthly payments to the Trust. All amounts expended by the IESO related to the Trust's carrying costs will be added to their regulatory variance account and will form the basis of future GA deferrals.
- As noted in the first point above, specified consumers have a statutory obligation to repay CEAs, such that when they commence repayment after the moratorium period, the full amount of the recovery is remitted to the Trust. Similar to the determination above, this statutory obligation links the consideration to a pool of specified consumers, and not a specific counterparty.