Confidential **Drafted: August 23, 2017**

FAIR HYDRO PLAN ACCOUNTING (GLOBAL ADJUSTMENT REFINANCING)

ISSUE: Why did the Auditor General qualify her opinion on the 2016-17 consolidated financial statements for including the market accounts of IESO in the consolidated financial statements?

CONTEXT: The Auditor General included the following qualification in her opinion on the 2016-17 consolidated financial statements:

> As described in Note 16c to these consolidated financial statements, the IESO changed its accounting policy and applied it retroactively to recognize market account assets and liabilities. The market accounts track mainly buy and sell transactions between market participants (electricity power generators and power distributors). These market accounts, as recorded on the Province of Ontario's consolidated financial statements are not assets and liabilities of the Province of Ontario. The Government has no access or discretion to use the market account assets for their own benefit, nor does the Government have an obligation to settle the market account liabilities in the event of default by market participants. As a result, Other Assets and Other Liabilities are both overstated by $1.652 billion (2016- $1.443 billion). There is no effect on the Consolidated Statement of Operations.

KEY MESSAGES:

- IESO financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS) and audited by a public accounting firm. IESO received an unqualified audit opinion on their December 31, 2016 financial statements that included the market accounts.

- IESO revisited its accounting for the market accounts in 2016 to determine what accounting policy was more transparent to the users of the financial statements.

- In completing its research, IESO analyzed the accounting used by the other independent system operators in North America, of which one is in Alberta and the balance (7) are in the United States. Seven of eight of these entities (excluding IESO) recognize the assets and liabilities of the market participants on a gross basis (i.e. they recognize their market accounts in their financial statements as IESO now does.) While none of these other entities prepare their financial statements in accordance with PSAS, the definitions of an asset and liability are very similar between PSAS and the accounting frameworks used by the North American ISOs (US GAAP and GASB).

- 2016 is not the first year that amounts due to power generators have been included in the financial statements.

    - IESO is the amalgamation of the former IESO and the Ontario Power Authority (OPA).

    - OPA, when it was a standalone entity, prepared its financial statements in accordance with Public Sector Accounting Standards, and recognized on its financial statements, the amounts due to the power generators and the amounts due from the IESO. These financial statements were audited by a public accounting firm, and an unqualified opinion was issued. The inclusion of the amounts due to the power generators was not raised as a concern by the current auditor general in 2013-14 or 2014-15 or by previous auditors general in the years since the OPA was established in fiscal 2004-2005.

    - OPA and IESO were amalgamated during 2015-16 and 2015-16 was the only year that balances related to a portion of the market accounts were not included in the province's consolidated financial statements.

- IESO is the contractual counterparty to the legal agreements with market participants – both power generators and local distribution companies. IESO has the responsibility for procuring supply, capacity and conservation measures, all of which are managed through the contracting with the generators. While IESO does not take ownership or control of the power generated prior to delivery to the ultimate consumers, it is nonetheless a party to the contracts, with an obligation to settle the market by paying the power generators and collecting from the local distribution entities, supporting recognition of the assets and liabilities.

Commented [VC(1]: Need a similar sentence for the LDCs

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Appendix

Proposed Legislated Transaction Structure

Prepared by the Office of the Auditor General of Ontario