ONTARIO POWER AUTHORITY

Memorandum

To: File
Date: March 22, 2012
Re: Accounting Treatment for OPA Charges, Other Financial Assets and Other Financial Liabilities

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1. Charges – Overview

"Charges" are amounts incurred by the OPA to recover amounts paid or payable by the OPA to another person <u>with respect to electricity</u>.

The OPA has a legislated responsibility to record the transactions flowing through the global adjustment mechanism. The global adjustment and settlement accounts have been created for this purpose. The global adjustment and settlement accounts record charges that flow between the OPA and the IESO. The account flows include the amounts paid and received for: Demand Response 2 (DR2), Demand Response 3 (DR3), non-utility generation (NUG), regulated nuclear generation balancing amount (nuclear) and regulated hydro electric generation balancing amount (hydro). These accounts are settled simultaneously by the IESO. The account also records the amounts paid and received for OPA contracts (standard offer, generation and conservation/demand management, Feed-In Tariff and hydroelectric contract initiatives) which the OPA settles on a monthly basis with the IESO.

The DR3, NUG, nuclear, hydro, and OPA contract balances are offset in the global adjustment account eliminating the need for a flow of funds between the IESO and the OPA. The OPA records the effect of the transactions to meet its legislated responsibility. The OPA's generation contracts are estimated each month and settled on the actual amount owing in the following month. This gives rise to timing differences. The settlement dates can cross calendar months, creating a monthly balance in the account. Differences created from timing or settlement dates are reclassified into <u>accounts receivable</u> at month end.

The OPA is entitled under legislation to recover eligible charge amounts, as per section 25.2 (3) of the Electricity Act:
(3) For greater certainty, the OPA may, subject to the regulations, establish and impose charges to recover from consumers its costs and payments under procurement contracts.

1.1 Accounting Treatment for OPA Contract and Conservation Charges

Charges are currently recorded as accounts receivable from the IESO in the OPA's financial statements, as they represent current assets that are recoverable within 1 year. Specifically, charges represent financial assets, as per **PS.S.1000.40** below and are only recorded as receivable once they have been incurred by the OPA. Under legislation, the OPA has a contractual right to receive cash from another party (in this case the IESO via the Global

Adjustment Mechanism) with respect to amounts incurred for eligible charge amounts. This concept is consistent with criteria (c) of the definition below:

*.**40*** *A financial asset is any asset that is:*

(a)cash;
(b)a realizable asset that is convertible to cash;
(c) a contractual right to receive cash or another financial asset from another party;
(d)a contractual right to exchange financial instruments with another party under conditions that are potentially favourable to the government;
(e)an equity instrument of another entity;
(f) an investment in a government business enterprise or government business partnership;
(g)a financial claim on an outside organization or individual; or
(h)an inventory or item for sale that meets the criteria in FINANCIAL STATEMENT PRESENTATION, paragraph **Error! Hyperlink reference not valid.**. *[Former paragraph* **Error! Hyperlink reference not valid.** *retained in Archived Pronouncements]*

Amounts Payable
Amounts payable arise for OPA contract charges when the value of HOEP exceeds the value of the suppliers' contract price. In this case, the charges would become an OPA liability to the market in the form of charges payable to the IESO (which, in turn, must be returned to the market via the Global Adjustment). Such charges payable to the market meet the criteria for recognition as a liability, as outlined below:

PS.3200.03

Liabilities should be recognized in the financial statements when:

(a) there is an appropriate basis of measurement; and
(b) a reasonable estimate can be made of the amount involved. [SEPT. 2004]

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2. Other financial assets and liabilities

Other financial assets and liabilities are made up of retailer settlement amounts, government procurements and regulated price plan variance amounts.

2.1 Other Financial Assets - Retailer Settlements and Government Procurements - Overview

Legislative provisions ensure that electricity retailers are made whole by the OPA for contracts with low-volume and designated consumers that were entered into before prices were frozen by legislation effective November 11, 2002. The OPA and retailers settling any differences between the HOEP and the contract price for each contract meet these provisions. When HOEP is greater than the contract price, the OPA receives payments from the retailers and records a financial liability. When HOEP is less than the contract price, the OPA pays the retailer and records a financial asset. The OPA tracks these variances in the retailer contract settlement deferral accounts. The retailer contract discount settlement account captures the funds related to the retailer incentives existing at the creation of the RPP. The retailer incentives captured are held in a separate deferral account for settlement concurrent with the retailer settlement deferral accounts.

The OPA began amortizing these costs over the period of 2009-2011 to reflect the recovery of these amounts through its annual usage rate approved by the OEB. As at December 31, 2011, the balances of the retailer settlements are nil and have been recovered in full.

The OPA reimburses the government for costs incurred for electricity procurement and records the costs as a financial asset. Any subsequent balances are included in future revenue requirement submissions. The OPA began amortizing the government procurement costs in 2009 on a straight-line basis, and as at December 31, 2011, the balance to recover for these costs is nil.

2.2 Accounting Treatment – Retailer Settlements and Government Procurements

Under PSAS, retailer settlements and government procurements are treated as other financial assets in the OPA's financial statements. As they are normally not recovered within one year, they are categorized as non-current assets. As per **PS.S.1000**, retailer settlement and government procurement balances qualify as financial assets as per criteria (c) below:

.**40** *A financial asset is any asset that is:*

- *(i) cash;*
- *(j) a realizable asset that is convertible to cash;*
- *(k) a contractual right to receive cash or another financial asset from another party;*
- *(l) a contractual right to exchange financial instruments with another party under conditions that are potentially favourable to the government;*
- *(m) an equity instrument of another entity;*
- *(n) an investment in a government business enterprise or government business partnership;*
- *(o) a financial claim on an outside organization or individual; or*
- *(p) an inventory or item for sale that meets the criteria in FINANCIAL STATEMENT PRESENTATION, paragraph* **Error! Hyperlink reference not valid.**. *[Former paragraph* **Error! Hyperlink reference not valid.** *retained in Archived Pronouncements]*

The OPA is required to carry the balance related to retailer settlement variances between the HOEP and contract price, as per legislation. The OPA is also entitled to recover these balances through legislative provisions, which represent a contractual right to receive cash or another financial asset from another party, as per criteria (c) above. Where retailer settlements fall into a liability balance, they would be categorized as other financial liabilities, as they would meet the criteria for recognition of a liability, as outlined in section 3.1 below.

3. Other Financial Liabilities – Regulated Price Plan (RPP) Variance - Overview

While prices for RPP consumers are set every six months by the OEB based upon a forecast of the cost of power over the next year, it is likely that there will be a difference between the actual and forecast cost of supplying electricity to all RPP consumers. When the hourly Ontario energy price (HOEP) is greater than the RPP, the OPA pays the excess amount and records a financial asset as the electricity market funds paid are receivable from the market. When the HOEP is less than the RPP, the OPA receives the difference and records a financial liability as the funds received will be returned to the market. The OPA tracks this variance in the RPP variance account.

3.1 Accounting Treatment – RPP

RPP variance amounts are recorded by the OPA as other financial liabilities in the financial statements, as they meet the liability criteria outlined below:

PS. S.1000

.45 *Liabilities have three essential characteristics:*

(a) they embody a duty or responsibility to others, leaving a government little or no discretion to avoid settlement of the obligation;

(b) the duty or responsibility to others entails settlement by future transfer or use of assets, provision of goods or services, or other form of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand; and

(c) the transactions or events obligating the government have already occurred.

Under legislation, the OPA is required to fund RPP variances where the HOEP is less than the RPP, which implies a duty or responsibility that the OPA has little to no discretion to avoid, as per criteria (a). For instances where the HOEP exceeds the RPP rate, the OPA would record a financial asset, as this circumstance would meet the criterion of **PS.S.1000.40** (financial asset), outlined in section 2.2 above.

External Auditor Approval of Accounting Treatment

The accounting treatment of OPA charges, retailer settlement, government procurement and RPP balances has been consistent since the OPA's inception and is approved by the OPA's external auditors on an annual basis. Based on governing legislation, the external auditors agree that these balances represent true assets and liabilities to the OPA. The signed auditors' report, along with the OPA's audited annual financial statements, can be found on the OPA website in the MD&A section of the OPA annual report.