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The execution of Ontario's Fair Hydro Plan Act, 2017 (the "Act") contemplates Ontario Power Generation ("OPG") creating a trust entity to purchase from the IESO the right to recover the IESO's funding shortfall.

As documented elsewhere (NOTE – INSERT REFERENCE), it is understood that under the structure of the Act, OPG will be considered under IFRS to control, and therefore, will consolidate the trust under IFRS. The remainder of this document assumes this to be the case.

OPG is considered a government business entity ("GBE") under PS 1300 and, accordingly, is accounted for by the Government using the modified equity method in accordance with GOVERNMENT REPORTING ENTITY, Section PS 1300.35. PSAS requires the financial statements of GBEs to be prepared in accordance with IFRS. Since OPG prepares its consolidated financial statements in accordance with US GAAP, adjustments to conform the statements to IFRS must be made prior to the application of the modified equity method. Accordingly, the remainder of the memo assumes OPG's financial statements are in accordance with IFRS.

Guidance on the application of the modified equity method is contained in INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070.

PS 3070.05 explains the modified equity method as follows:

> *Under the modified equity method, the equity method of accounting is modified only to the extent that the government business enterprise's accounting principles are not adjusted to conform with those of the government. Thus, the government aggregates a government business enterprise's net assets and net income by adjusting the investment shown in the government's consolidated statement of financial position and by presenting the net income as a separate item on the government's consolidated statement of operations.*

Accordingly, the application of the modified equity method effectively results in OPG's net assets and net income being consolidated in the GRE on a one-line basis, ignoring any differences between PSAS and IFRS.

Since the trust is consolidated into OPG on a line-by-line basis, the net assets and net income of the trust will be included in the GRE through the application of the modified equity method on OPG.

As mentioned above, the trust entity will purchase from the IESO the right to recover the IESO's funding shortfall. This document assumes that the proceeds received from the trust will be equal to the funding shortfall. As documented elsewhere (NOTE – INSERT REFERENCE), it is understood that this acquired right meets the criteria to be recognized as an intangible asset under IFRS in the financial statements of the trust. The remainder of this document assumes this to be the case.

Although FINANCIAL STATEMENT CONCEPTS, Section PS 1000.58 precludes the recognition of intangible assets under PSAS, the application of the modified equity method generally permits the indirect recognition of intangible assets owned by a GBE in the financial statements of the GRE through its investment in the GBE. However, the value of the intangible asset held by the trust that can be recognized in the financial statements of the GRE may be impacted by the following guidance in PS 3070.07 that requires the elimination of any unrealized inter-organizational gains and losses on assets remaining within the GRE at the financial statement date:

*The investment in a government business enterprise, as reflected in government financial statements under the modified equity method, includes the cost of the government's investment in the government business enterprise, calculated in accordance with paragraphs PS 3070.10-.11, and, subsequent to the date when the use of the modified equity method first became appropriate, also includes adjustments for:*
*….*
*(e) the elimination of any unrealized inter-organizational gains and losses on assets remaining within the government reporting entity at the financial statement date;*

Unrealized inter-organizational gains and losses relating to the intangible asset purchased by the trust will exist to the extent that purchase price paid by the trust differs from the carrying value of the asset in the IESO's books immediately prior to the sale. Accordingly, as illustrated below, the conclusion as to whether or not the IESO can recognize regulatory assets will significantly impact the accounting for the execution of the Act in the financial statements of the GRE.

The IESO is an other government organization ("OGO"). OGOs are government units and are consolidated on a line-by-line basis in the financial statements of the GRE in accordance with GOVERNMENT REPORTING ENTITY, Section PS 1300.27. OGOs are required to follow PSAS. Under PSAS, the accounting for inter-entity transactions is governed by INTER-ENTITY TRANSACTIONS, PS 3420. In accordance with PS 3420.09, an inter-entity transaction involving the transfer of assets or liabilities requires the provider to remove the assets or liabilities from its financial statements and any difference between the net proceeds received, if any, and the carrying amounts transferred would be accounted for as a revenue or expense in the statement of operations.

Situation #1 – Recognition of Regulatory Assets by IESO Permitted

The shortfall incurred by IESO is recognized as a regulatory asset is as follows:

| IESO | | |
|---|---|---|
| DR | RRA | 100 |
| CR | Cash | -100 |

The sale to OPG trust of the right to recover the shortfall in the future is as follows:

| IESO | | |
|---|---|---|
| DR | Cash | 100 |
| CR | RRA | -100 |

| Trust | | |
|---|---|---|
| DR | Intangible | 100 |
| CR | Cash | -100 |

Since the IESO did not recognize a gain or loss on the sale transaction, there is no unrealized inter-organizational gain or loss relating to the intangible asset held indirectly by the GRE that needs to be eliminated.

Situation #2 – Recognition of Regulatory Assets by IESO Not Permitted

The shortfall incurred by IESO is expensed as follows:

| IESO | | |
|---|---|---|
| DR | Expense | 100 |
| CR | Cash | -100 |

The sale to OPG trust is as follows:

| IESO | | |
|---|---|---|
| DR | Cash | 100 |
| CR | Gain on Sale | -100 |

| Trust | | |
|---|---|---|
| DR | Intangible | 100 |
| CR | Cash | -100 |

The IESO recognizes a gain on the sale transaction equal to the proceeds received. The value of the intangible asset recognized by the trust is equal to the gain recognized by the IESO. In the preparation of the financial statements of the GRE, the gain recognized by the IESO is eliminated against the GRE's investment in the GBE, bringing the value of the intangible asset recognized indirectly in the investment in the GBE to nil.

| GRE | | |
|---|---|---|
| DR | Gain | 100 |
| CR | Investment in GBE | -100 |