January 8, 2018

DAY 2 ACCOUNTING CONSIDERATIONS FOR THE FAIR HYDRO PLAN UNDER US GAAP

Purpose:

The purpose of this document is to summarize the preliminary views of Ontario Power Generation (OPG or the Company) on:

- the applicability of US GAAP for Trust accounting purposes, and
- the expected 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. 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 US GAAP" for OPG's analysis on its ability to consolidate the Trust.

Background:

In June 2017, the Province enacted the Ontario Fair Hydro Plan Act, 2017 (the Fair Hydro Act or the Act), to establish a framework under which the costs and benefits associated with the Government of Ontario's (the Province) clean energy initiatives are to be fairly allocated between present and future consumers of electricity under the Fair Hydro Plan. The Act requires the Ontario Energy Board (OEB) to set rates that reduce average electricity bills for specified consumers by 25 percent commencing on July 1, 2017. The total bill reduction of 25 percent is comprised of an 8 percent reduction of the Provincial portion of the harmonized sales tax, with the remaining 17 percent achieved by decreasing energy rates for specified consumers paying the Regulated Price Plan rate and providing a global adjustment reduction credit for other specified consumers. The reduction in electricity bills will result in a shortfall in the Independent Electricity System Operator's (IESO) collections, which will need to be financed over a longer period in order to pay the underlying GA costs.

Key Transactional Highlights:

- Pursuant to the Act, the Independent Electricity System Operator (IESO) will determine the shortfall resulting from the rate reduction on a monthly basis and record the amount in a variance account. The Act refers to this shortfall balance as a Regulatory Asset.
- The IESO may offer for sale a specified portion of the Regulatory Asset to the Trust pursuant to a Master Transfer and Servicing Agreement (MTSA) in return for cash proceeds.
- Upon the sale of a specified portion of the Regulatory Asset to the Trust, the Trust acquires a GA deferral asset which is a right to collect, among other things, future cash flow streams representing:
    - o principal repayments 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 Act stipulates that the IESO cannot collect the balance recorded in the variance account from specified consumers through clean energy adjustments (CEAs) before May 1, 2021 (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 repayments and true up amounts. CEA payments will continue until all debt issued by the Trust is repaid.
- During the period from December 1, 2017 to July 31, 2021, the IESO will pay for the carrying costs of the Trust pursuant to section 9.1 (1) of the General Regulation. These costs will then be added to the IESO's regulatory variance account pursuant to section 16 of the General Regulation, which specified consumers have the ultimate obligation to bear.
- In order for the Trust to fulfil its business purpose of financing the GA deferral, it plans to raise debt through the following sources:

Tranche and Debt Type	Source of Funding	% of Total Funding Requirement
Tranche A Senior Debt	Capital Markets (privately-placed debt)	51%
Tranche B Subordinated Debt	OPG via Province (equity injections)	39%
Tranche C Junior Subordinated Debt	OPG via Province (equity injections)	5%
	OPG via Capital Markets (Medium-term note program – public debt)	5%

- As the Trust will be 100% debt funded, it will have no cash at inception to settle its obligations. Section 3.14(b) of the MTSA stipulates that the IESO will provide the Trust cash in advance to pay for carrying costs expected to be incurred in the following calendar month (includes interest, bond issuance fees, trustee fees, legal and audit fees, reserve requirements, etc.). The pre-funding process is expected to start in December 2017 whereby the Trust will submit a request to the IESO in the form of Exhibit C of the MTSA for estimated upcoming obligations. In subsequent months, the Trust will true-up actual amounts paid and adjust the next month's request accordingly per section 3.14(d) (i.e. if the Trust paid less than expected and there is excess funds, the next month's request to the IESO will be lower by the amount of the excess).

Key Program Agreements

The program documents/agreements referenced herein include the following:

- Master Transfer and Servicing Agreement – December 21, 2017
- Management Agreement – December 20, 2017
- Master Trust Indenture – December 21, 2017

Applicability of US GAAP for Trust Accounting

Consideration was given as to which accounting standard will be applicable to the Trust – IFRS or US GAAP. The following supports that US GAAP could be utilized for Trust accounting purposes:

- The Trust is contemplated to only issue privately placed debt in Canada (and potentially in the United States if there is not enough market capacity in Canada), where there will be no public filings of a prospectus or other material on SEDAR/EDGAR. Accordingly, the Trust would have no reporting issuer status (venture issuer and/or Canadian Reporting Issuer) and IFRS is not mandatory.
- There are no program agreements that require the use of a particular accounting standard. The only requirement pursuant to section 13.09 of the Master Trust Indenture is for the Trust to deliver to the indenture trustee and the rating agencies, (i) audited annual financial statements within 140 days after the end of each fiscal year and (ii) unaudited financial statements within 90 days after the end of each fiscal quarter.

Conclusion: As IFRS is not mandatory for the Trust's stand-alone financial statements, US GAAP will be used to be consistent with OPG's reporting framework.

Accounting Issues:

A. How should this GA deferral asset be classified?

B. How should the GA deferral asset be initially and subsequently measured?

C. How should revenue/income and expenses related to this asset be accounted for?

Accounting Analyses:

A. How should this GA deferral asset be classified?

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

Guidance for Financial Asset Classification

- ASC 825 – Financial Instruments
- ASC 860 – Transfers and Servicing

ASC 825-10-20 defines a financial asset as:

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

1. *Receive cash or another financial instrument from a second entity*
2. *Exchange other financial instruments on potentially favorable terms with the second entity'*

To evaluate whether the 'right to collect' can be classified and recognized as a financial asset under US GAAP, management examined the following key elements from the above definition:

1. Does the purchase of the 'right to collect' by the Trust constitute a contract between the Trust and another entity?

Management considered the guidance in ASC 606 to determine if a right to collect cash or another financial instrument has arisen via a contract between the Trust and another entity.

Guidance

US GAAP ASC 606-10-20 defines a contract as ‘an agreement between two or more parties that creates enforceable rights and obligations’.

The following excerpts from *Section 2.6* of the *PwC Revenue from Contracts with Customers* states:

- A contract can be written, oral, or implied by an entity’s customary business practices
- Generally, an agreement that creates legally enforceable rights and obligations meets the definition of a contract

The *Ontario Fair Hydro Act, 2017* (Fair Hydro Act or the 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 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.

Section 9.1 of General Regulation establishes the IESO legislative obligation to pay for the Trust’s carrying costs during the moratorium period. In particular, it states that:

(1) During the period beginning on December 1, 2017 and ending on July 31, 2021, the IESO shall pay and remit to a financing entity any amounts charged to the IESO by the financing entity in respect of carrying costs of the financing entity during the period beginning on June 1, 2017 and ending on July 31, 2021.

The carrying costs of the Trust refers to the sum of: interest, derivative payment, 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.

Analysis

After the Trust purchases portions of the GA deferral asset from the IESO, it provides the Trust with the ‘right to collect’ future cash flows. Management believes that this transaction represents a contract during and after the moratorium period given there are legally enforceable, statutory rights as follows:

- The IESO to pay the Trust its carrying costs during the moratorium period which is premised on the fact that the costs they incur are added to the GA costs and therefore recoverable from specified ratepayers once CEAs are charged to specified consumers in 2021

- the Trust, having acquired the GA deferral asset, to collect the CEAs from specified consumers in Ontario, with the IESO and electricity vendors acting as intermediaries in the collection process after the moratorium period
- the IESO to collect the requisite CEAs from electricity vendors and to remit its collections to the Trust in the latter's capacity as owner of the GA deferral asset after the moratorium period
- electricity vendors to invoice and collect the requisite CEAs from specified consumers and remit it to the IESO after the moratorium period
- specified consumers to pay the requisite CEAs specified in their invoices to the electricity vendors after the moratorium period

In addition to the statutory rights listed above, the Trust is conveyed the rights to receive the cash flows associated with the GA deferral asset through the MTSA, a legally binding contract between the IESO as servicer and the Trust. Specifically, section 3.6 of the MTSA stipulates the details of the remittance process the IESO is obligated to perform to pay the Trust monies owing related to the GA deferral asset.

Conclusion: Management believes that there exists a legally enforceable contract that enables cash receipts from IESO, which is conditional on the IESO receiving funds/collections from specified consumers through electricity vendors. Refer to below analysis in regards to the counterparty to this contract.

2. Who is the second entity the Trust has the right to receive the cash from (i.e. the counterparty to the contract)?

Guidance

The Fair Hydro Act states the following:

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.*

Part III, Section 16(1):

The IESO shall, as an agent of the investment interest owners, receive amounts in respect of the clean energy adjustment paid to it from electricity vendors in accordance with the market rules made under section 32 of the Electricity Act, 1998 or the regulations.

Part III, Section 17(3):

Each electricity vendor shall, as agent of the investment interest owners, collect amounts in respect of the clean energy adjustment from specified consumers in accordance with the regulations.

Part V, Section 25(3):

The IESO shall not be entitled to collect all or part of the balance recorded in the variance account from specified consumers before May 1, 2021.

Analysis

Management assessed which of the below entities, either individually or in combination, would serve as the "second entity" or the counterparty in the above contract, which provides the Trust with the 'right to collect':

- The IESO
- Electricity vendors

- Specified consumers

OPG transacts solely with the IESO in settling payments and receipts; OPG does not interact with the electricity vendors or specified consumers directly. However, the above-noted clauses in the legislation indicate the IESO and electricity vendors are acting in the capacity of agents representing the owner of the GA deferral asset (i.e. the Trust). The responsibilities, duties and powers of the electricity vendors and the IESO are confined to only collecting the CEA from the specified consumers and remitting it to the Trust, respectively.

Management also considered the impact of the moratorium instituted by the Province of Ontario, wherein ratepayers cannot be charged CEAs until May 1, 2021. During this time, the IESO has a legislative obligation to pay for the Trust's carrying costs under the expectation that specified consumers bear the ultimate obligation through the repayment of CEAs.

However, the IESO does recognize collections from electricity vendors and payments to the electricity vendors in the normal course on a gross basis as revenue and cost of sales, respectively. Therefore, another viewpoint is that the IESO has sold a future revenue stream to the Trust, from a future specified consumer pool. The IESO has an obligation to remit those future revenues to the Trust as discussed under question 1 above. While the ultimate source of cash will be the specified consumers in Ontario (through payments to the electricity vendors), it is the MTSA with the IESO that has generated the right to receive the future cash stream. Under this viewpoint, the counterparty to the contract is the IESO.

Considering a more common situation, in a normal, non-regulated sale of future revenues by a trading entity, there is an obligation to pass on uncommitted revenues from an unknown future customer/client pool. In this more common situation, while the purchaser of such a stream of revenues will not receive any cash unless revenues actually occur, it is the obligation of the trading entity to pay the revenues, once generated, to the purchaser of the stream. We would generally not think about this arrangement as being a contract between the unknown future customers of the trading entity and the purchaser of the revenue stream. Rather, we would usually think about this as a contract between the trading entity and the purchaser of the stream, even though the passing on of cash flows is conditional on there being actual customers in the future.

The fact that the future cash inflows are rate regulated, and required under legislation to be paid by specified consumers in Ontario, brings more uncertainty to the analysis of who the counterparty is. However, because it is a contract between the Trust and the IESO that creates the right to receive cash, management believes it is more reasonable to identify the IESO as the counterparty.

Conclusion: Considering the various viewpoints above, management concludes that the "second" entity or the counterparty to the contract is the IESO.

3. Given a contract exists, does it provide the Trust with a right to a) receive cash or another financial instrument from the second entity or b) exchange other financial instruments on potentially favorable terms?

Guidance

The *Fair Hydro Act* states the following:

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.

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.

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 investment interest owners:

a) 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...

Excerpt from section 3.6 of the MTSA:

3.6 Remittances

b) Absent the occurrence of a Daily Remittance Event, the Issuer Share of Servicer CEA Receipts received by the Servicer and any interest earned thereon received on or subsequent to a Remittance Date shall be remitted by the Servicer to the Collection Account no later than the immediately following Remittance Date.

Where Servicer CEA Receipts pertain to any amounts the IESO receives in respect of CEAs that are payable directly by specified consumers to the IESO (per section 3.4(e) of the MTSA).

Conclusion: Based on the above noted provisions of the Fair Hydro Act and the MTSA, management is of the view that the "contract" between the Trust and the IESO provides the Trust with legally enforceable statutory and contractual rights to receive future cash streams related to the GA deferral asset.

There is judgement in assessing whether the right to receive cash under the Act represents a financial asset or some other type of asset.

On the one hand, rate regulated assets are non-financial assets under US GAAP. When the Trust purchases the regulatory asset from the IESO, its entitlement is substantively the same as the entitlement as that of the IESO, and therefore there is an argument that this asset cannot qualify as a financial asset under US GAAP. On the other hand, the Trust's entitlement to cash flows arising from purchasing the regulatory asset arose from the MTSA between the IESO and the Trust. In considering this, there is a contrary viewpoint that the right to collect future cash flows arose from a contract rather than rate regulation.

In further assessing whether the GA deferral asset can be classified as a financial asset, management also considered the guidance relating to securitized stranded costs.

Guidance

ASC 860-10-55-8 through -10 state that (emphasis added):

55-7 The deregulation of utility rates charged for electric power generation has caused electricity-producing entities (utilities) to identify some of their electric power generation operations as stranded costs. Before deregulation, utilities typically expected to be reimbursed for costs through regulation of rates charged to customers. After deregulation, some of these costs may no longer be recoverable through unregulated rates. Hence, such potentially unrecoverable costs often are referred to as stranded costs. However, some of those stranded costs may be recovered through a surcharge or tariff imposed on rate-regulated goods or services provided by another portion of the entity whose pricing remains regulated. Some entities have securitized their enforceable rights to impose that tariff (often *referred to as securitized stranded costs), thereby obtaining cash from investors in exchange for the future cash flows to be realized from collecting surcharges imposed on customers of the rate-regulated goods or services.*

55-8 Securitized stranded costs are not financial assets, and therefore transfers of securitized stranded costs are not within the scope of this Subtopic. Securitized stranded costs are not financial assets because they are imposed on ratepayers by a state government or its regulatory commission and, thus, while an enforceable right for the utility, they are not a contractual right to receive payments from another party. <u>To elaborate, while a right to collect cash flows exists, it is not the result of a contract and, thus, not a financial asset</u>.

55-9 <u>However, beneficial interests in a securitization trust that holds nonfinancial assets such as stranded costs or other similar imposed rights would be considered financial assets by the third-party investors</u>, unless that third party must consolidate the trust. The Variable Interest Entities Subsections of Subtopic 810-10 should be applied, together with other guidance on consolidation policy, as appropriate, to determine whether such a special-purpose entity should be consolidated by a third-party investor.

<u>Analysis</u>

Beneficial interests is defined as "*rights to receive all or portions of specified cash inflows received by a trust or other entity including, but not limited, to all of the following: senior and subordinated shares of interest, principal, or other cash inflows to be passed through or paid-through, premiums due to guarantors, commercial paper obligations, residual interests, whether in the form of debt or equity."*

The rationale in ASC 860-10-55-8 that stranded costs are not financial assets is that they do not arise via contract. In the case of the Trust, the right to collect the GA deferral does arise from the MTSA contract with the IESO. However, given that the Trust is a financial investor rather than a rate regulated entity, it appears that the Trust's accounting is more closely covered by ASC 860-10-55-9 than ASC 860-10-55-8 and 9.

Therefore, management believes that the Trust has beneficial interest in the GA deferral asset as its acquisition of the GA deferral asset provided the Trust with the rights to receive CEAs from specified consumers after the moratorium and receive carrying costs via the IESO during the moratorium period.

<u>Conclusion</u>: This guidance, further supports that the GA deferral asset giving the Trust the 'right to collect' is a structured financial asset.

Management also considered alternate arguments that the asset is either an intangible asset or a rate regulated asset.

(i) Intangible Asset

US GAAP ASC 350-30-20 defines intangible assets as *assets (not including financial assets) that lack physical substance.*

As noted above, one might view that ASC 860 is not definitive on classification of the GA deferral asset as a financial asset.

While the 'right to collect' asset lacks physical substance, management is of the view that this characteristic is not sufficient to overcome the guidance in ASC 860, as discussed above. The criteria in ASC 860 are more prescriptive than the much broader definition of an intangible asset in subtopic 350-30. Given financial assets are excluded from the scope of intangible assets and the 'right to collect' asset having met the criteria to be classified as a financial asset, management concludes that it is not an intangible asset.

In assessing this classification, management also considered the guidance under ASC 470-10-25-1 and ASC 470-10-25-2 relating to sales of future revenues. This guidance is not directly applicable as the IESO has sold a cost deferral rather than future revenues, and furthermore the Trust is the purchaser rather than the seller of the asset, but it provides further evidence of whether the Trust's interest is more financial or non-financial in nature under US GAAP. From the Trust's perspective, the criterion set out in ASC 470-10-25-2(d) relating to the investor's rate of return being implicitly or explicitly limited by the terms of the transaction is satisfied given the following Trust's transactions:

- The GA deferral asset acquired from the IESO equals the debt that is issued
- The interest revenue received from the IESO is equal to the interest expense owing to bondholders
- The management fee revenue received from the IESO is equal to the management fee expense owing to OPG
- The third party reimbursement revenue from the IESO is equal to the third party expense owing to OPG

As these transactions net the Trust zero (or minimal) income, management is of the view that the Trust's rate of return is limited by the terms of the transactions.

The guidance states that if any of the criteria is met, there is a rebuttable presumption that classification of the proceeds as debt is appropriate. While this particular guidance is not directly applicable, as noted above, it is consistent with the viewpoint that from the perspective of the Trust, the cash flow stream related to the GA deferral asset is more financial than non-financial in nature.

While management has not performed any analysis on the IESO's proposed accounting treatment, the conclusion that the GA deferral asset is a financial asset is not inconsistent with the IESO's conclusion that the proceeds from the Trust will not be recorded as debt. In particular, the transfer, as noted above, is not within the scope of ASC 470, and furthermore, the IESO is not applying US GAAP.

(ii) Regulatory Asset

Given the Trust has no regulated operations, management concludes the subtopic 980 is not applicable. Although OPG consolidates the Trust, the costs underpinning the 'right to collect' are not specifically related to OPG's incurred costs as a result of being a rate-regulated entity and having injected electricity into the IESO-controlled grid for the benefit of customers. Rather, the 'right to collect' stems from a legislated right to receive a cash flow stream from future specified consumers, as well as the Trust's purchase of that right from the IESO via MTSA contract. Thus, the 'right to collect' asset cannot be classified as a regulatory asset under US GAAP.

ACCOUNTING ISSUE A CONCLUSION:

Based on the supporting discussion above, management concludes that the GA deferral asset representing a 'right to collect' from future specified consumers meets all of the criteria for classification as a **<u>financial asset</u>**.

Refer to *Appendix A* for the corresponding illustrative journal entries.

Refer *to Appendix B* for the proposed presentation.

The financial asset can be further refined in classification, therefore, management first considered whether the GA deferral asset would be within the scope of *ASC 325 Investments – Other*, specifically whether the asset is reflective of a beneficial interest in securitized financial asset.

Per <u>*ASC 325-40-15-3 (emphasis added):*</u>

*The guidance in this Subtopic applies to beneficial interests that have **<u>all</u>** of the following characteristics:*

a. Are either debt securities under Subtopic 320-10 or required to be accounted for like debt securities under that Subtopic pursuant to paragraph 860-20-35-2.

Both sub-criterion are not applicable.

- Subtopic 320-10-20 defines "debt security" as "*any security representing a creditor relationship with an entity*". The GA deferral asset is a 'right to collect' future cash flows from future specified consumers, which is not reflective of a creditor relationship between the Trust and said consumers.
- Subtopic 860-20-35-2 pertains to financial assets "*that can be contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment*". Per the MTSA, the GA deferral asset will be recovered through monthly collections of carrying costs during the moratorium period and CEAs after the moratorium and the Trust is expected collect CEAs until the underlying debt is fully recovered.

b. *Involve securitized financial assets that have contractual cash flows (for example, loans, receivables, debt securities, and guaranteed lease residuals, among other items). Thus, the guidance in this Subtopic does not apply to securitized financial assets that do not involve contractual cash flows (for example, common stock equity securities, among other items). See paragraph 320-10-35-38 for guidance on beneficial interests involving securitized financial assets that do not involve contractual cash flows.*

Applicable. The MTSA outlines the contractual nature of the future cash flows the Trust is entitled to, both through carrying costs during the moratorium period and when CEAs start to be repaid by specified consumers after the moratorium period.

c. *Do not result in consolidation of the entity issuing the beneficial interest by the holder of the beneficial interests.*

Applicable. The Trust, as the owner of the GA deferral asset, purchases it from the IESO. This transaction does not result in the consolidation of the IESO by the Trust.

d. *Are not within the scope of Subtopic 310-30.*

Applicable. Subtopic 310-30 "*applies to all loans with evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable*". There is no current or expected risk of credit quality deterioration as the collection of future cash flows is dependent on having future specified consumers in Ontario.

e. *Are not beneficial interests in securitized financial assets that have* ***both*** *of the following characteristics:*

1. *Are of high credit quality (for example, guaranteed by the U.S. government, its agencies, or other creditworthy guarantors, and loans or securities sufficiently collateralized to ensure that the possibility of credit loss is remote)*

   Applicable. The GA deferral asset will not be a rated instrument, however, the underlying debt tranches are expected to be investment grade rated (i.e. Tranche A – AAA-AA, Tranche B – AA-A, Tranche C – A-BBB).

2. *Cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment.*

   Applicable. The GA deferral asset is not recovered through prepayments and the Trust is expected collect on said asset in its entirety from future specified consumers. Other than the IESO prefunding the Trust with the expected carrying costs in the following month (see section 3.14 of the MTSA) to provide cash flows to meet its obligations, the MTSA provides for the monthly collection of carrying costs (during the moratorium) and CEAs (after the moratorium). The prepayment structure in place does not result in a contractual prepayment that would result in an inability to recover the investment in full.

Applicable. The GA deferral asset has both of the above characteristics.

Conclusion:

Not all the criteria are applicable, therefore, the GA deferral asset is not within the scope of ASC 325 *Investments – Other*

Next, management assessed whether the GA deferral asset is within the scope of *ASC 320 – Investments – Debt and Equity Securities.*

ASC 320-10-15-6 "*applies to all loans that meet the definition of a security*." *ASC 320-10-20* defines a security as follows (emphasis added):

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has ***all*** *of the following characteristics:*

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

Not applicable. The GA deferral asset is not an instrument that is issued in bearer or registered form. Its purchase is facilitated by the issuance of a Transfer Notice from the IESO to the Trust, which is not reflective of being registered in books maintained by the IESO.

b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

Not applicable. The GA deferral asset is not commonly dealt in on securities exchanges or markets. Additionally, it is not represented by an instrument as discussed above.

c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Not applicable. The GA deferral asset is a 'right to collect' and the related terms therein is not divisible into a class or series that is representative of shares, participations, interests, or obligation. Only the underlying debt will be identifiable by series.

Conclusion:

Since the GA deferral asset does not meet the definition of a security, it is not within the scope of ASC 320 – *Investments – Debt and Equity Securities*.

Finally, management considered additional guidance in the receivables subtopic as they are representative of financial assets that confer on the holder a right to receive cash. According to ASC 310-10-15-2, there are a variety of instruments and transactions that a receivable could be including trade accounts receivable, loans, loan syndications, factoring arrangements, standby letters of credit, and financing receivables. The definitions for each were assessed, and management is of the view that the financial asset best represents a **financing receivable**.

ASC 310-10-20 defines financing receivables as:

A financing arrangement that has both of the following characteristics:

a. *It represents a contractual right to receive money in either of the following ways:*

   1. *On demand*

   Not applicable. The Trust is constrained by statute and the contractual terms of the MTSA. In particular, the Trust cannot receive on demand payments as the Act stipulates that CEAs cannot be collected from specified consumers until after May 1, 2021 and there is an agreed-upon monthly remittance process in place (as noted above) with the IESO for the carrying costs.

   2. *On fixed or determinable dates*

   Applicable. The 'right to collect' financial asset held by the Trust represents a contractual right to receive cash (either in the form of carrying costs or CEAs) from specified consumers via the IESO. The monthly remittance process per the MTSA is structured around the monthly billing cycle of specified consumers. In particular, the remittance of cash from the IESO to the Trust happens on the 18th business day of the following month (per the definition of "remittance date" in the MTSA). Therefore, management believes criterion 2 is met as there exists a contractual right for the Trust to receive money on determinable dates.

b. *It is recognized as an asset in the entity's statement of financial position.*

   Applicable. The 'right to collect' will be recognized as a financial asset in the Trust's (and ultimately, OPG's) statement of financial position.

B. How should the GA deferral asset be initially and subsequently measured?

Guidance

ASC 820 – Fair Value Measurement

ASC 310 – Receivables

Issue B – Analysis

Initial Measurement

The Trust will measure the GA deferral asset using the fair value of the transaction or the transaction price in line with the guidance outlined in ASC 820-10-30-3 (see below). In making this determination, management also considered the following factors outlined in ASC 820-10-30-3A that could be indicators that the transaction price might not be the fair value:

a. *The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms.*

   The Trust is not related to the specified consumers, however, the Trust through OPG is related to the IESO, the OEB and the Province. Management assessed the indirect relationships of the different stakeholders in the transaction and concluded that each are all acting within their usual role in the electricity market, with the IESO as the system operator, the OEB as the rate-setter, and the Province as policy maker. The way the transaction price is derived is as follows:

   - The Province passed the Act which mandated a 25% reduction in specified consumers' electricity bills;

- The OEB then sets rates so that it is 25% lower than it would have been otherwise without the Act;
- The IESO measures the shortfall in their usual collections, records that shortfall in a variance account and sells specified portions to the Trust. The transaction price is equivalent to the specified portion of the shortfall measured by the IESO.

The Act also stipulates that interest cost is payable on the outstanding amount of debt used to finance the deferral. This interest cost will be paid at the current market rate and therefore, the GA deferral asset will be earning a market rate of return.

Based on how the transaction price is determined, management is of the view that it represents market terms in that the amount is based on an objective and measurable process without the related parties impacting the price.

Further, management considered whether an exit price would be more appropriate. Given that there are no other similar transactions like this in Canada, and there are no known buyers that would buy the asset (instead of the Trust), management concluded that using exit price as fair value is not possible.

b. The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

Not applicable.

c. The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value….

Not applicable.

d. The market in which the transaction takes place is different from the principal market (or most advantageous market).

Not applicable.

ASC 820-10-30-3:

In many cases, the transaction price will equal the fair value (for example, that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).

Subsequent Measurement

As concluded in Issue A above, the GA deferral asset can be characterized as a financing receivable. Accordingly, management considered the subsequent measurement guidance in ASC 310 Receivables and noted that the following provision is applicable to the GA deferral asset:

"Loans and trade receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff shall be reported in the balance sheet at outstanding principal adjusted for any chargeoffs, the allowance for loan losses (or the allowance for doubtful accounts), any deferred fees or costs on originated loans, and any unamortized premiums or discounts on purchased loans…." (ASC 310-10-35-47)

ACCOUNTING ISSUE B CONCLUSION:

The GA deferral asset will be measured at the transaction price upon acquisition and subsequently measured on an amortized cost basis. The basis of amortization will follow the interest method according to the guidance provided below. Depending if there is a day 1 discount or premium, the Trust will amortize the day 1 balance as either interest income or interest expense monthly on a straight line basis over the term of the note (refer to *Appendix A*).

ASC 835-30-25-9:
The difference between the face amount and the present value upon issuance is shown as either discount or premium.

ASC 835-30-35-2:
*With respect to a note for which the imputation of interest is required, the difference between the present value and the face amount shall be treated as discount or premium and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. This is the **interest method**.*

ASC 835-30-35-3:
The difference between the periodic interest cost so calculated using the interest method and the nominal interest on the outstanding amount of the debt is the amount of periodic amortization.

C. How should revenue/income and expenses related to this asset be accounted for?

Accounting Discussions:

1) **How should the Trust account for the interest income that will result from the accretion of the financial asset and the compensation it will receive from OPG?**
2) **How should the Trust account for the different cash flow streams it will receive from the IESO?**
3) **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?**
4) **How should OPG account for the revenue associated with the portion of the Global Adjustment related to its own cost recovery?**

Guidance:

ASC 606 Revenue from Contracts with Customers

Accounting Discussions:

1) **How should the Trust account for the interest income that will result from the accretion of the financial asset and the compensation it will receive from OPG?**

Interest Income

The interest income earned by the Trust is based on the accretion of the GA deferral asset the Trust has provided to the IESO. It is earned as a percentage on each tranche of funding issued to-date and the amount earned would be impacted by the prevailing market interest rates, the passage of time and the underlying pool of funding. 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 by the Trust is not within the scope of ASC 606-10-15-3 which states (emphasis added):

“An entity shall apply the guidance in this Topic to a contract (other than a contract listed in paragraph 606-10-15-2) 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. 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.”

At the end of every month, the Trust will accrete the balance of each tranche of debt that funded the GA deferral asset using the effective interest rate to derive interest income and a corresponding entry to increase the financial asset.

The illustrative entries are:

Dr. Financial Asset
Cr. Interest Income

To record the monthly accretion of the financial asset as a result of the passage of time, measured at the effective interest rate multiplied by the balance of the financial asset.

<u>Trust's Remuneration from OPG</u>

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. Because this amount is nominal, no further analysis was performed.

The Trust will recognize gross revenue on a monthly basis when cash is received from OPG under the account heading "Issuer Fee Revenue", however, the impact will eventually be eliminated as it is an intercompany transaction.

The illustrative entries are:

Dr. Cash
Cr. Issuer Fee Revenue
To record receipt of the monthly remuneration from OPG pursuant to the Management Agreement.

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

To determine the appropriate accounting treatment for the monies received by the Trust, the nature of the recovery will be determined – if it is revenue or cost recovery. If it is revenue, the guidance on principal versus agent considerations will be analysed to distinguish the roles between OPG and the Trust in providing the good/service. This consideration is important because being a principal or an agent for each promised good or service have different accounting treatments. In particular:

- a **principal** recognizes revenue in the **gross** amount of consideration it expects to be entitled as it satisfies the related performance obligation (ASC 606-10-55-37B), whereas,
- an **agent** would recognize revenue in the amount of **net** fee or commission to which it expects to be entitled as it satisfies the related performance obligation in exchange for arranging for the specified goods/services to be provided by the other party (ASC 606-10-55-38).

If it is cost recovery, the accounting treatment is determined accordingly and discussed in the relevant sections below.

The following criteria for principal versus agent considerations were assessed from the Trust's perspective, with OPG as the other party and the IESO as the customer.

<u>ASC 606-10-55-37</u>

"To determine the nature of its promise (as described in paragraph 606-10-55-36), the entity should:

a) Identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party [see paragraph 606-10-25-18])

b) *Assess whether it controls (as described in paragraph 606-10-25-25) each specified good or service before that good or service is transferred to the customer."*

Per the above guidance, management will identify the specified goods or services to be provided and determine whether the Trust controls it before the transfer to the IESO using the following criteria:

<u>ASC 606-10-55-37</u> (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. However, <u>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."

<u>ASC 606-10-55-37A</u> (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 606-10-25-21(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 include goods or services from other parties) and directs their use to create the combined output that is the specified good or service.*

Management will further consider the following criteria to determine if the Trust is the principal:

<u>ASC 606-10-55-38</u>

"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."

<u>ASC 606-10-55-39</u>

"Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal [see paragraph 606-10-55-37]) 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 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.*

d) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

e) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

<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. As noted under accounting discussions #1, interest income earned is not within the scope of ASC 606-10-15-3, because the bank is not the Trust's customer.

<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.

The illustrative entries are:

Dr. Cash
    Cr. Interest Income (bank account balances)

To recognize the interest income earned on the Trust's bank accounts when credited at the end of the month.

Dr. Expense
    Cr. Cash
To recognize the use of excess cash in the Trust's bank accounts for any type of carrying costs/expenses as it is incurred.

Principal repayments

This is a recovery of the 'right to collect' financing receivable as defined above, and this transaction will not have an income statement impact. A financial asset is a financial instrument within the scope of subtopic 825 and not within the scope of ASC 606. Therefore, the 'right to collect' financial asset and the related principal repayments are not revenue within the scope of ASC 606.

Conclusion:

Monies representing the repayment of principal will be embedded in the CEAs specified consumers will pay in the future. When payment of CEAs commence, the Trust will bifurcate the portion related to principal repayments and record it as a reduction to the financial asset using the effective interest rate multiplied by the outstanding balance of the financial asset.

The illustrative entries are:

Dr. Cash
    Cr. Financial Asset
To record the repayment of the principal which underlies the financial asset when specified consumers commence repayment via CEAs. The portion of the CEA relating to principal will be calculated using the effective interest rate.

Receipt of interest payments from the IESO and related repayment of interest expense

The receipt of cash from the IESO related to the interest incurred on the financial asset does not have an impact on the income statement of the Trust, similar to the principal payments as described above. Once cash is received, the Trust will then have funds to use to repay the interest obligations of the Trust on the related outstanding debt when they come due. In particular, it will remit 100% of the proceeds related to interest expense to OPG for its 49% investment in the subordinated debt tranches and the remaining 51% will be payable to external debtholders. The amount to be recovered by the Trust is based on the stated coupon rate applied to each respective tranche (Tranches A to C) of funding issued to-date and the passage of time.

The Trust expects to receive pre-funding from the IESO related to interest expense ahead of when the amount is due to debtholders. 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. Refer to "*Key Transactional Highlights"* section above for more details.

Conclusion:

When the monthly pre-funding of carrying costs are received from the IESO, the Trust will record cash with an offset to a liability account as the interest expense has not yet been incurred. The interest expense will be realized as interest is accrued through the passage of time, with the offset to interest payable. The Advances from the IESO and interest payable accounts will be decreased when the liability is settled, with an offset to cash and the financial asset. The entries will result in a net income statement impact of nil. This is consistent with the flow through nature of the cash and expense in the Trust (i.e. the Trust receives cash recovery for interest costs and remits the same to debtholders).

The illustrative entries are:

Dr. Cash
Cr. Advances from the IESO (interest expense)
To record the pre-funding related to interest expense for the next period received from the monthly IESO carrying costs remittance.

Dr. Interest Expense
Cr. Interest Payable
Dr. Advances from the IESO (Interest Expense)
Cr. Financial Asset
To record the interest expense and the related liability on all outstanding tranches of debt, as well as to record the offset to the financial asset and Advances from the IESO liability. The reduction in both the Advances from the IESO liability and financial asset accounts would coincide with the related interest expense, when it is earned through the passage of time.

Dr. Interest Payable
Cr. Cash
To record the settlement of interest expense liability related to all tranches of outstanding debt.

OPG's Management Fees

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 noted above that management fees will not be assessed through the 5-step revenue recognition model as the amount expected to be earned is relatively not material in dollar terms.

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

Control assessment:

ASC 606-10-55-37A

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 ASC 606-10-55-37 (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.

ASC 606-10-55-39

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.

d) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

e) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

<u>Conclusion</u>:

Based on the criteria assessed above, management concludes that the Trust is acting as an agent for OPG (who is the principal) 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).

The illustrative entries are:

Base Management Fees	**Variable Management Fees**
Dr. Cash Cr. Advances from IESO (OPG's base management fee) *To record the receipt of the IESO's monthly pre-funding for OPG's base management fees (once approved for the year by the OEB).*	No equivalent entries, the variable fees will not be pre-funded by the IESO as it needs to be approved by the OEB first per the General Regulation.
Dr. Expense – Management Fees Cr. Payable – OPG *To accrue monthly base management fees payable to OPG when invoiced by OPG.*	Dr. Expense – Management Fees Cr. Payable – OPG *To accrue variable management fees payable to OPG annually at year-end when invoiced.*
Dr. Advances from IESO (OPG's base management fee) Cr. Contra Expense – Management Fees *To reduce the Advances from IESO liability account as base management fees are payable by the Trust to OPG.*	Dr. Receivable – IESO Cr. Contra Expense – Management Fees *To record invoicing the IESO for OPG's variable management fees at the end of the year.*
No equivalent entry, the expense will be pre-funded by the IESO (see 1st entry).	Dr. Cash Cr. Receivable – IESO *To record cash received from the IESO.*
Dr. Payable – OPG Cr. Cash *To record remittance of payment to OPG.*	Dr. Payable – OPG Cr. Cash *To record remittance of payment to OPG.*

<u>Trust-incurred third party costs</u>

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. 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 ASC 835-30-45-1A, where debt issuance costs related to a note is reported in the balance sheet as a direct deduction from the face amount of that note and shall not be classified as a deferred charge or deferred credit.

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

Control assessment:

ASC 606-10-55-37A

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 ASC 606-10-55-37 (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.

ASC 606-10-55-39

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.

d) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*
e) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

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 bifurcated from the total cash balance, 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.

The illustrative entries are:

Dr. Cash
    Cr. Advances from IESO (third-party costs)
To record the pre-funding related to third-party costs for the next period received from the IESO through the monthly carrying costs remittance process.

Dr. Expense – Trust-incurred Third-Party Expense

Cr. Trade Payable
Dr. Advances from IESO (third-party costs)
Cr. Cost Recovery Revenue
To record the related expense and payables related to Trust-incurred third-party costs.

Dr. Trade Payable
Cr. Cash
To record the settlement of liabilities related to Trust-incurred third-party costs

OPG-incurred third party costs

In addition to the Trust-incurred costs, OPG is also expected to incur third-party costs on behalf of the Trust related to the FHP Program. Such costs may include agency fees, trustee fees, legal and audit fees, etc. 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.

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 expenses, that they were incurred by OPG, and that 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 as part of OPG's duties as manager under the Management Agreement.

Control assessment:

ASC 606-10-55-37A

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 ASC 606-10-55-37 (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>ASC 606-10-55-39</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.

d) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

e) *[Subparagraph superseded by Accounting Standards Update No. 2016-08].*

<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.

The illustrative entries are:

Dr. Expense – OPG Third-Party Costs
    Cr. Payable – OPG
To record OPG's third-party costs and expenditures when OPG invoices the Trust. OPG will be out-of-pocket for these expenses until the IESO reimburses the costs annually after the OEB's review.

Dr. Unbilled Revenue (asset)
    Cr. Contra Expense – OPG Third-Party Costs
To record the unbilled revenue asset from the IESO for OPG's third-party costs incurred on behalf of the Trust when OPG invoices the Trust.

Dr. Receivable – IESO
    Cr. Unbilled Revenue (asset)
To record the Trust's invoice to the IESO at the end of the year for OPG-incurred third party costs.

Dr. Cash
    Cr. Receivable – IESO
To record cash received from the IESO annually for third party costs and expenditures incurred by OPG on behalf of the Trust.

Dr. Payable – OPG
    Cr. Cash
To record the remittance of third-party expenses to OPG annually.

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3) 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?

<u>Management fee income</u>

As concluded in issue #1(iii) above, OPG is the principal in the specified services 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 ASC 606 as OPG is providing a service for which specified consumers provide consideration (through carrying costs and 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 cause variability 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 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 ASC 606-10-15-3 (excerpt is noted above under accounting discussion item 1), because the Trust is not OPG's customer (i.e. it is not buying electricity from OPG in exchange for the interest income).

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.

The illustrative entries are:

Dr. Receivable – Fair Hydro Trust
    Cr. Interest Income
To recognize the interest income on OPG's subordinated debt investment in Tranche B and Tranche C of the Trust in line with the dates per the underlying supplemental indenture.

Dr. Interest Expense
    Cr. Cash
To recognize interest expense associated with OPG's borrowings (i.e. 5% of debt) invested in Tranche C.

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 of incurrence.

For third-party expenses OPG has/will incur for the Fair Hydro Program, OPG's expense account related to Fair Hydro will be debited with a corresponding entry to payable when the obligation arises (upon receipt of third party invoice). 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, management believes that the definition of an asset has been met at this point as it:

- Represents 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), and
- Results from past transactions where OPG had incurred the costs for the Fair Hydro Plan.

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 an asset. The most appropriate asset type is an unbilled revenue account because OPG will not be invoicing the Trust until the end of the year as noted above.

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.

The illustrative entries are:

Dr. Expense – Fair Hydro Trust
    Cr. Payable
To recognize OPG's incurrence of third-party expenses related to the Fair Hydro Plan when OPG is invoiced by the third party vendor.

Dr. Unbilled Revenue (asset)
    Cr. Cost Recovery Revenue – Fair Hydro Trust
To recognize the unbilled revenue asset related to OPG-incurred third-party expenses when OPG is invoiced by the third party vendor.

Dr. Payable
    Cr. Cash
To record the settlement of third party invoices OPG incurs for the Fair Hydro Plan. OPG will settle the liability before reimbursement is received from the Trust, as these costs are only recoverable once a year at the beginning of the following year.

Dr. Receivable – Fair Hydro Trust
    Cr. Unbilled Revenue (asset)
To recognize the receivable from the Trust for OPG-incurred third-party expenses when OPG invoices the Trust at the end of the year.

Dr. Cash
    Cr. Receivable – Fair Hydro Trust
To recognize cash reimbursement from the Trust the following year.

For the 2017 third-party costs OPG incurred for the Fair Hydro Plan, management believes that OPG has rights to the recovery of the costs when the General Regulation was amended on November 3, 2017 to include the relevant provisions in section 10.2. Specifically, OPG is entitled to the sum of the following:

- $3.1 million, which is comprised of a $600,000 management fee and $2.5 million to cover third-party costs incurred prior to June 1, 2017.
- Recovery of third-party costs incurred and paid between June 1 and December 31, 2017, including the direct costs of OPG employees who are dedicated exclusively to Fair Hydro matters.

As noted above, management believes that the OEB's review of OPG-incurred third-party costs is perfunctory in nature. The appropriate accounting trigger for the asset recognition is the amendment of the General Regulation in November 2017, specifically section 10.2, which gives OPG the rights to the above-noted fees. Accordingly, OPG will record the cost recovery revenue with the offset to the unbilled revenue asset account for all of the costs it has incurred to-date and will book a receivable from the Trust at the end of the year in line with the OEB costs review timeline. OPG will use this accounting treatment for the same type of costs going forward.

Compensation for the Trust

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. Because this amount is nominal, no further analysis was performed and OPG does not intend to seek recovery of the costs from the OEB. The Trust will recognize gross revenue on a monthly basis under the account heading "Issuer Fee Revenue" as cash is received from OPG.

The illustrative entries are:

Dr. Cash
    Cr. Issuer Fee Revenue
To recognize remuneration from OPG pursuant to the Management Agreement.

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4) How should OPG account for the revenue associated with the portion of the Global Adjustment related to its own cost recovery?

Analysis

Part of the GA charged to specified consumers is related to OPG's electricity generation, through a rate regulated or supply contract mechanism (i.e. OPG's generation revenue). As such, the question arises as to how this amount should be recognized from OPG's perspective.

As noted above, the Trust will recognize a financial asset related to the GA deferral asset it acquires from the IESO, which represents a portion of the deferred GA. The rationale for this is that OPG has a right to future cash flow streams that the IESO will be collecting from specified consumers (i.e. CEAs), pursuant to legislation.

The Trust providing financing to specified consumers should be viewed separately from OPG's regular cost recovery for electricity generation. The Trust and OPG are two separate legal entities providing different services. OPG is an electricity market participant providing generation, and has a regulatory right to be paid for the electricity it generates independent of the Fair Hydro Plan. Meanwhile in OPG's role as FSM, it manages the Trust to provide the financing for the GA deferral, which is outside of market rules and separate from its principal business as an electricity generator.

The GA deferral through the Fair Hydro Plan is determined at a holistic, system-wide basis with no direct link to specific GA values triggered by payment to OPG for both regulated rates and contracted generation amounts. Additionally, the Trust is not obligated to purchase the GA deferral asset, and will be making an investment decision on a case-by-case basis. With the combination of other demand management / conservation payments also included in the GA, specific attribution is not possible or warranted.

Conclusion:

OPG's remuneration for its participation in the market as a generator is in accordance with legislative right that entitles OPG to recover its generation costs along with earning a fair return and rates established in its electricity supply contracts. The collection of said rates occurs within the parameters set by the Market Rules for Ontario's electricity participants. The Trust providing financing for the GA deferral will be separate from its regular revenue recognition. Accordingly, OPG's current revenue accounting is not impacted by this consideration.

APPENDIX A – Fair Hydro Trust and OPG Illustrative Journal Entries

The following journal entries will be recorded by the Fair Hydro Trust:

Acquisition of funding

Dr. Cash
    Cr. Short/Long-term debt – Senior – External
    Cr. Short/Long-term debt – Subordinated – OPG [1]

To record the funding acquired by the Trust from all sources for the GA deferral asset purchase from IESO.

Initial recognition of financial asset

Dr. Financial Asset (LT asset)
    Cr. Cash

To record the purchase of the GA deferral asset from the IESO which will be recognized at the transaction price.

Accretion of financial asset

Dr. Financial Asset
    Cr. Interest Income

To record the monthly accretion of the financial asset as a result of the passage of time, measured at the effective interest rate multiplied by the balance of the financial asset.

Recognize the receipt of the monthly pre-funding by the IESO

Dr. Cash
    Cr. Advances from IESO (Interest Expense)
    Cr. Advances from IESO (OPG's Base Management Fees)
    Cr. Advances from IESO (Trust-incurred Third-Party Costs)

To record receipt of the pre-funding from the IESO for the following month's expenses as requested by the Trust from the IESO via Exhibit C Monthly Carrying Costs Statement in the MTSA.

Monthly accrual of interest on debt and recognition of the Advances from IESO liability and related decrease in financial asset

Dr. Interest expense
    Cr. Interest Payable
Dr. Advances from IESO (Interest Expense)
    Cr. Financial Asset

To record the interest expense and the related liability on all outstanding tranches of debt, as well as to reduce the financial asset and Advances from IESO liability account. The reduction in both the Advances from IESO liability and financial asset accounts would coincide with the related interest expense, when it is earned through the passage of time.

Remittance of interest to debtholders and settlement of liability

Dr. Interest Payable
    Cr. Cash

[1] This portion of the entry is for illustrative purposes only. OPG's portion of debt funding would not necessarily coincide with the Trust's senior debt tranche issuance.

To record the settlement of interest expense liability related to all tranches of outstanding debt.

Accrue OPG's management fees and related payable

Dr. Expense – Management fees
Cr. Payable – OPG
To accrue management fees payable to OPG (monthly for base fees and after the issuance of senior debt for variable fees) when invoiced by OPG.

Reduce Advances from IESO liability account for base management fees

Dr. Advances from IESO (OPG's Base Management Fees)
Cr. Contra Expense – Management Fees
To reduce the Advances from IESO liability account that resulted from the IESO's pre-funding of Trust expenses as base fees become payable to OPG.

Invoice the IESO for OPG's variable management fees

Dr. Receivable – IESO
Cr. Contra Expense – Management fees
To record invoicing the IESO for OPG's variable management fees receivable from the IESO.

Receive payment for management fees

Dr. Cash
Cr. Receivable – IESO
To record cash received from IESO for variable fees (annually).

Remittance of management fees to OPG

Dr. Payable – OPG
Cr. Cash
To record the remittance of the management fees earned by OPG as the Trust's Financial Services Manager.

Record invoice from OPG for third-party expenses

Dr. Expense – OPG Third party expenses
Cr. Payable – OPG
To record OPG's third party costs and expenditures when invoiced by OPG. OPG will be out-of-pocket for these expenses until the IESO reimburses the costs annually.

Record invoicing the IESO for OPG's third-party expenses

Dr. Receivable – IESO
Cr. Contra Expense – OPG Third party expenses
To record the receivable from the IESO for OPG's third-party expenses incurred during the year at the end of the year.

Receive payment for OPG-incurred third-party expenses

Dr. Cash
Cr. Receivable – IESO
To record cash received from IESO annually for third party costs and expenditures incurred by OPG on behalf of the Trust.

Remittance of third-party expenses to OPG

Dr. Payable – OPG
    Cr. Cash
To record the remittance of third party expenses to OPG annually (in the following year when they were incurred).

Record third party expenses incurred by the Trust

Dr. Expense – Trust-incurred Third-Party Expense
    Cr. Trade Payable
Dr. Advances from IESO (third-party costs)
    Cr. Cost Recovery Revenue
To record the revenue, related expense, and payables related to Trust-incurred third-party costs.

Settle the Trust-incurred liabilities with third parties

Dr. Trade Payable
    Cr. Cash
To record the settlement of liabilities related to Trust-incurred third-party costs.

Record Trust's remuneration from OPG

Dr. Cash
    Cr. Issuer Fee Revenue
To record receipt of the monthly $10 remuneration from OPG pursuant to section 5.5 of the Management Agreement when cash is received.

Recognize interest income earned from the Trust's bank accounts

Dr. Cash
    Cr. Interest Income (bank account balances)
To recognize the interest income earned on the Trust's bank accounts when credited at the end of the month.

Recognize use of excess cash from the Trust's bank accounts to pay for other obligations per the payment waterfall

Dr. Expense
    Cr. Cash
To recognize the use of excess cash in the Trust's bank accounts for any type of carrying costs/expenses as it is incurred.

Repayment of principal from specified consumers via CEAs

Dr. Cash (from CEAs via IESO)
    Cr. Financial Asset
To record the repayment of the principal which underlies the financial asset when specified consumers commence repayment via CEAs. The portion of the CEA relating to principal will be calculated using the effective interest rate.

Repayment of principal to debtholders

Dr. Short/Long-term debt – Senior – External
Dr. Short/Long-term debt – Subordinated – OPG
    Cr. Cash
    Cr. Cash – Reserve Account (if applicable)
To record repayment of principal to debtholders as the debt comes due.

The following journal entries will be recorded by OPG:

Equity injection from Province

Dr. Cash
Cr. Equity
To record the Province's equity contribution to purchase GA deferral assets from the IESO equivalent to 44% of the funding requirement of each tranche.

Borrow from capital markets

Dr. Cash
Cr. Long-term Debt
To raise funds from capital markets for OPG's 5% funding requirement investment into the Trust as Tranche C.

Make subordinated debt investment into Trust

Dr. Long-term Notes Receivable
Cr. Cash
To record OPG's periodic subordinated debt investment in the Trust comprised of the Province's 44% and OPG's own investment of 5% of the funding requirement.

Record interest expense on OPG's long-term debt/external borrowing

Dr. Interest expense
Cr. Cash
To accrue monthly interest expense payable on OPG's external borrowing (i.e. Tranche C of the Trust's debt).

Record interest income on OPG's subordinated debt investment

Dr. Receivable – Fair Hydro Trust
Cr. Interest Income
To recognize the interest income on OPG's subordinated debt investment in Tranche B and Tranche C of the Trust at the end of each month.

Record cash receipt from the Trust for interest income on Tranche B and C

Dr. Cash
Cr. Receivable – Fair Hydro Trust
To recognize the cash remittance for interest income from the Trust.

Record third-party expenses related to the Fair Hydro Plan

Dr. Expense – Fair Hydro Trust
Cr. Payable
To record incurrence of third party expenses related to the Fair Hydro Plan when OPG is invoiced by third party providers.

Record unbilled revenue asset

Dr. Unbilled Revenue (asset)
Cr. Cost Recovery Revenue – Fair Hydro Trust

To recognize the unbilled revenue asset related to OPG-incurred third-party expenses when OPG is invoiced by the third party vendors. OPG will not invoice the Trust until the end of the year when the expenses will be submitted to the OEB.

Record settlement of third-party expenses related to the Fair Hydro Plan

Dr. Payable
Cr. Cash
To record the settlement of third party invoices OPG incurs for the Fair Hydro Plan.

Record the receivable for OPG-incurred third-party expenses

Dr. Receivable – Fair Hydro Trust
Cr. Unbilled Revenue (asset)
To recognize the receivable from the Trust for OPG-incurred third-party expenses when OPG invoices the Trust at the end of the year.

Record cash receipt from Trust for third party expenses

Dr. Cash
Cr. Receivable – Fair Hydro Trust
To record annual cash receipt from the Trust related to third party expenses incurred by OPG on behalf of the Trust early the following year.

Recognize revenue on management fees

Dr. Receivable – Fair Hydro Trust
Cr. Management Fee Revenue
To recognize revenue for OPG's management fees as FSM.

Record cash receipt from Trust for management fees

Dr. Cash
Cr. Receivable – Fair Hydro Trust
To record cash receipt from the Trust related to management fees (monthly for base fees and after each issuance of senior debt for variable fees).

Appendix C has details on the illustrative elimination entries.

APPENDIX B – Consolidation and Proposed Presentation

(in millions of dollars)

Refer to Appendix C – Illustrative Entries for the source of the figures used in the tables below, as well as the elimination entries.

<u>Fair Hydro Trust Income Statement:</u>

Interest Income	(41)
Issuer Fee Revenue [1]	(0)
Cost Recovery Revenue - Third Party Expenses	(5)
Interest Expense	41
Net Management Fee Expenses [2]	(0)
Trust-incurred Third Party Expenses	5
Net OPG-incurred Third Party Expenses [2]	(0)
Net (Income) Expense	**(0)**

1. The amount will not be material ($10/month) and rounds to nil millions.
2. The Trust is the agent in the transaction, therefore, the balance is reported net.

<u>Fair Hydro Trust Balance Sheet</u>

Cash	4
Receivable – IESO [1]	3
Financial Asset	1,000
Payable – OPG [2]	(3)
Advances from IESO [3]	(4)
Short Term/Long Term Debt – Senior – External	(510)
Short Term/Long Term Debt – Subordinated – OPG [2]	(490)
Net Assets	**-**

1 At the end of the year, the Trust will have receivables from the IESO related to the annual variable fee and OPG-incurred third party costs. These costs will be settled in cash the following year (the later of (1) last day of the month when the amount was determined or (2) last day of the month following the month in which the OEB approves the fees).
2 These amounts eliminate upon consolidation.
3 At the end of each period, the Trust will have a liability equivalent to the pre-funding provided by the IESO related to the following month's forecast expenditures relating to interest expense, approved OPG's base management fees, and Trust-incurred third-party expenses per the MTSA.

<u>OPG Consolidation of Select Balance Sheet Items:</u>

Given that it was concluded that OPG controls the Trust, the balance sheet of the Trust will consolidate line by line with OPG's consolidated balance sheet, including any eliminating entries.

	OPG	**Trust**	**Eliminations**	**CONSOL**
Cash	19	4	-	23
Receivable – Fair Hydro Trust [1]	3	-	(3)	0
Long-term Notes Receivable [1]	490	-	(490)	0
Financial Asset	-	1,000	-	1,000
IESO Receivable	-	3	-	3
Payable – OPG [1]	-	(3)	3	-
Advances from IESO	-	(4)	-	(4)
Short Term/Long Term Debt – Senior – External	-	(510)	-	(510)
Short Term/Long Term Debt – Subordinated – OPG	(50)	(490)[1]	490	(50)
Equity	(462)	-	-	(462)
Net Assets	**-**	**-**	**-**	**-**

1 These amounts eliminate upon consolidation.

OPG Consolidation of Select Income Statement Items:

	OPG	Trust	Eliminations	Consol Adj [3]	CONSOL
Management Fee Revenue [1]	(1)	-	1	(1)	(1)
Cost Recovery Revenue [1]	(2)	(5)	-		(7)
Issuer Fee Revenue [1,2]	-	(0)	0		-
Interest Income	(23)[1]	(41)	23		(41)
Interest Expense	3	41	(23)		21
Expense - Fair Hydro Trust	0	-	(0)		-
Management Fee Expenses	-	-	(1)	1	-
Trust-incurred Third Party Expenses	-	5	-		5
OPG-incurred Third Party Expenses	2	-			2
Net (Income) Expense	**(22)**	**(0)**	**-**	**-**	**(22)**

1 These amounts eliminate upon consolidation.
2 The amount will not be material ($10/month) and rounds to nil millions.
3 This column represents post-consolidation adjustments to reclassify the contra expense accounts related to the management fees from the Trust.

The table below illustrates the proposed presentation for the consolidated income statement of OPG. Upon consolidation, “Earnings from Fair Hydro Trust” will be presented as a separate line item in OPG’s consolidated statement of. The line item will encapsulate the net of all the income statement transactions of the Trust, after elimination and adjustment entries. There is no readily available or explicit guidance under US GAAP, however, management referred to Regulation S-X Rule 5-03 Income Statements, §210.5-03.7. The relevant excerpt is as follows (emphasis added):

“The purpose of this rule is to indicate the various line items which, if applicable, and except as otherwise permitted by the Commission, should appear on the face of the income statements filed for the persons to whom this article pertains (see §210.4-01(a)).

7. Non-operating income.

State separately in the income statement or in a note thereto amounts earned from (a) dividends, (b) interest on securities, (c) profits on securities (net of losses), and <u>(d) miscellaneous other income</u>. Amounts earned from transactions in securities of related parties shall be disclosed as required under §210.4-08(k). <u>Material amounts included under miscellaneous other income shall be separately stated in the income statement or in a note thereto, indicating clearly the nature of the transactions out of which the items arose</u>.”

- The article pertains to entities who file financial statements with the Securities Exchange Commission. Regardless of the intended application, management believes that this guidance, specifically the classification as miscellaneous other income, is relevant to OPG’s proposed presentation and will provide meaningful and relevant disclosures for users of OPG’s financial statements. Further, management believes that the “Earnings from Fair Hydro Trust” presentation is appropriate given that the transaction is an investment by OPG, in which it expects to earn a return. The alternative of including the earnings in interest income is not appropriate, as OPG will be offsetting interest expense as in the normal course of business. The net earnings of this transaction pertain directly to the financing operations of the Fair Hydro Trust, which is not similar in nature from OPG’s principal business of electricity generation. Management notes that the proposed presentation is similar to the current way the segregated nuclear funds earnings is presented in OPG’s consolidated statement of income, albeit for different reasons.

In addition, the notes to OPG’s consolidated financial statements will include the appropriate level of disclosure to indicate the nature of the Trust’s transactions out of which the net earnings arose as required by §210.5-03.7.

Illustrative OPG Consolidated Income Statement (select items)

Revenue	$500
Fuel Expense	$300
Gross Margin	**$200**
[Expenses] [1]	
OM&A	$50
Depreciation and Amortization	$25
Earnings on nuclear segregated funds	($80)
Earnings from Fair Hydro Trust [2]	**($22)**
Income before other (Gains) losses, interest and income taxes	**$227**
Other (gains) losses	$0
Income before interest and income taxes	**$227**
Net interest expense	$10
Income before income taxes	**$217**
Income tax expense	$10
Net income	**$207**

1. The subheading will need to be updated to reflect a more appropriate caption.
2. The proposed 'Earnings from Fair Hydro Trust' income statement line item will effectively consist of net earnings from the services provided by OPG to the Trust and net earnings from its subordinated debt investment i.e. a) management fee revenue and b) interest income on the subordinated debt issued to the Trust (via MOE equity injections).