

To: Imbrogno, Serge (ENERGY)[Serge.Imbrogno@ontario.ca]
From: Katona, Keley (ENERGY)
Sent: Sat 2/25/2017 1:32:43 AM
Subject: Fw: ASC 980

Rec 108

FYI

From: Nelms, Scott (ENERGY) <Scott.Nelms@ontario.ca>
Sent: Friday, February 24, 2017 7:13 PM
To: Hume, Steen (ENERGY); Calwell, Carolyn (ENERGY/MEDEI/MRI); Katona, Keley (ENERGY)
Subject: Fw: ASC 980

Based on the following, Michel is suggesting OEB may need to be involved. Likely more conversations to come over the weekend.

Scott
Sent from my BlackBerry 10 smartphone on the Rogers network.

From: Picard, Michel <mpicard@kpmg.ca>
Sent: Friday, February 24, 2017 6:40 PM
To: Kim Marshall
Cc: Ouellette, Lois A; Betik, Matthew; Nelms, Scott (ENERGY)
Subject: ASC 980

Kim,

Further to our meeting of today, I have the following comments:

1. Based on the following requirements, I believe IESO can only recognize a regulatory asset if the activities are rate regulated i.e. meet the criteria in par. 15-2.

980-10-15-2 The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria:

- a. A) The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers. [Is this test met – maybe another body could regulate the GAM recovery but it needs to be a body that meet the requirements in 980-10-15-7 below]
- b. b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form. If an entity's regulated rates are based on the costs of a group of entities and the entity is so large in relation to the group of entities that its costs are, in essence, the group's costs, the regulation would meet this criterion for that entity.
- c. C) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs. This last criterion is not intended as a requirement that the entity earn a fair return on shareholders' investment under all conditions; an entity can earn less than a fair return for many reasons unrelated to the ability to bill and collect rates that will recover allowable costs. For example, mild weather might reduce demand for energy utility services. In that case, rates that were expected to recover an entity's allowable costs might not do so. The resulting decreased earnings do not demonstrate an inability to charge and collect rates that would recover the entity's costs; rather, they demonstrate the uncertainty inherent in estimating weather conditions. This requirement must also be evaluated in light of the circumstances. For example, if the entity has an exclusive franchise to provide regulated services or products in an area and competition from other services or products is minimal, there is

usually a reasonable expectation that it will continue to meet the other criteria. Exclusive franchises can be revoked, but they seldom are. If the entity has no exclusive franchise but has made the very large capital investment required to provide either the regulated services or products or an acceptable substitute, future competition also may be unlikely.

2. As indicated in par. 15-4, if the “market books” are not rate regulated then IESO cannot adopt regulatory accounting – ie cannot recognize regulatory assets. I was under the impression that the RPP variance accounts were approved by the OEB. Today, I learned that they are not.

980-10-15-4 If some of an entity's operations are regulated and meet the criteria of paragraph 980-10-15-2, this Topic shall be applied to only that portion of the entity's operations.

3. According to 5-08, IESO needs an accounting order from a regulator.

980-10-05-8 Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP.

4. According to 15-7, you need a regulator that is not a party to the contract.

980-10-15-7 The guidance in the Regulated Operations Topic does not apply to any of the following transactions:

- a. a) Accounting for price controls that are imposed by governmental action in times of emergency, high inflation, or other unusual conditions, or accounting for contracts in general. However, if the terms of a contract between an entity and its customer are subject to regulation and the criteria of paragraph 980-10-15-2 are met with respect to that contract, the guidance in this Topic shall apply.
- b. C) The criterion in paragraph 980-10-15-2(a) is intended to exclude contractual arrangements in which the government, or another party that could be viewed as a regulator, is a party to a contract and is the entity's principal customer.

5. I am not sure how to read this next par.

980-10-05-7 Accounting requirements that are not directly related to the economic effects of rate actions may be imposed on regulated businesses by orders of regulatory authorities and occasionally by court decisions or statutes. This does not necessarily mean that those accounting requirements conform with generally accepted accounting principles (GAAP). For example, a regulatory authority may order an entity to capitalize and amortize a cost that would be charged to income currently by an unregulated entity. Unless capitalization of that cost is appropriate under this Topic, GAAP requires the regulated entity to charge the cost to current income.

I still believe that absent a rate regulator or a governing body approving the rates, then there is no recognition of regulatory asset.

Since the MOE can change the rule, I would suggest that the OEB Act be amended requiring the OEB to oversee the GAM recovery.

Can we discuss over the weekend?

Michel

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