Accounting Changes Key Messages and Q&As

March 2017

Key Messages

- The IESO has made changes to its accounting policies to increase transparency and to report certain costs as regulated assets, consistent with the accounting policies of other regulated entities in North America. The changes include the recognition of rate regulated assets as well as the recognition of market accounts assets and liabilities on the statement of financial positions.
- It`s important to note that these items do not affect IESO's costs and the impact on ratepayers does not change.
- The IESO's usage fee decreased from 2012 to 2016.

Market Accounts

- The IESO operates and settles the electricity market, where sums of money are constantly flowing to and from market participants, such as consumers and generators.
- The IESO is not party to these market transactions but facilitates them, which requires it to temporarily hold and move money.
- These financial transactions in no way impact the IESO's accumulated deficit or revenues and expenses.
- After a review of its accounting practices, the IESO decided to include year-end market account balances on its financial statements in an effort to increase transparency.
- As the market administrator, the IESO is best suited to report these financial activities.

Regulated Assets – PSAB and SME

- The IESO has changed its accounting policy to report certain costs as regulated assets consistent with the accounting policies of other regulated entities in North America.
- These are costs that are being recovered through IESO rates and it is common practice among regulated entities to treat such costs as regulatory assets for accounting purposes.

- It`s important to note that no matter which way you report these costs, the cost and the impact on ratepayers does not change.
- These costs have been in our publicly issued audited financial statements for years and therefore part of our ongoing annual review by the OEB. The decision to move to the new accounting policy was made to better reflect the nature of these costs.
- The reporting of these costs has always been public and the new reporting is simply a function of change in accounting policy.

Q&As

1. **Why are you only now beginning to report market transactions on your financial statements?**

There is no requirement for the IESO to report market accounts. However, the IESO regularly explores ways to improve transparency and make data and information available to its stakeholders and the general public. As part of a recent review of its accounting policies, the IESO approved reporting market accounts to increase transparency.

2. **Why did the IESO determine that the new accounting policy on rate-regulated accounting was more relevant to the IESO?**

After reviewing its accounting policies, it was determined that rate-regulated accounting was more applicable to regulated entities such as the IESO. This is consistent with the accounting policies of other regulated entities across North America. In Ontario, almost all local distribution companies and natural gas distribution companies use rate regulated accounting.

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3. **Did the IESO lose or discover that it owed $80M?**

This sum is not an additional cost to ratepayers and relates to pension and other post-employment benefits and has been included in the IESOs rate submissions to the Ontario Energy Board since 2011. The sum stems from accounting changes the IESO made when it adopted the Canadian public sector accounting standards in 2011. The new accounting standards required the IESO to recalculate pension and other post-employment benefits. This sum reflects the difference in methodology between the old accounting standards and the new. Ultimately, none of this changes the actual cost of the pension and other post-employment benefit plans or the benefits earned by members.

4. **If you kept the previous accounting standards would ratepayers had to bear this $80M cost?**

The $80 million is being included in the IESO's rate in the same manner under both accounting standards. .

5. **Why is the $80M called "previously unrecognized actuarial losses and past service costs" if it's not a loss?**

Calculating pension and other post-employment benefits is a forecasting exercise that requires a number of assumptions and estimations. These expenses fluctuate each year, sometimes as a loss and sometimes as a gain. The most common sources of gains and losses are investment returns which differ from expected, as well as changes in liability resulting from changes in the discount rate used to measure the obligation. Ultimately, none of this changes the actual cost of the pension and other post-employment benefit plans or the benefits earned by members.

Background:

The IESO accrues obligations under pension and other post-employment benefit (OPEB) plans and the related costs, net of plan assets. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimate of expected return on plan assets, salary escalation, retirement ages of employees, mortality and expected health-care costs. The discount rate used to value liabilities is based on the expected rate of return on plan assets as at the measurement date of September 30.

The expected return on plan assets is based on management's long-term best estimate using a market-related value of plan assets. The market-related value of plan assets is determined using the average value of assets over three years as at the measurement date of September 30.

Pension and OPEB expenses are recorded during the year in which employees render services. Pension and OPEB expenses consist of current service costs, interest expense on liabilities, expected return on plan assets and the cost of plan amendments in the period. Actuarial gains/(losses) arise from, among other things, the difference between the actual rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. Actuarial gains/(losses) are amortized over the expected average remaining service life of the employees covered by the plan.

6. **Did the IESO review its accounting policies as a result of its role in refinancing the global adjustment?**

The IESO regularly reviews its accounting policies although this review was triggered by discussions with government. The IESO's review determined that including market accounts would increase transparency and reporting certain costs as regulated assets was consistent with the accounting policies of other regulated entities across North America. Even if the government refinancing plan does not proceed, the IESO would have made the change.

7. **How does the IESO's accounting policy change facilitate the government's global adjustment refinancing plan?**

We don't have a lot of information to provide at the moment as the legislation to enable the government's plan has yet to be introduced. However, at a high level, the IESO's accounting policies change would facilitate the proposed global adjustment refinancing.

8. **Why is the IESO's rate increasing?**

The IESO anticipates a four per cent increase is required in its usage fees to support ongoing work with stakeholders on the Market Renewal project, which is expected to result in about $3.5 billion in cost savings from 2021-2030. The anticipated usage fee will continue to be less than the combined fees of the Ontario Power Authority and former IESO before the January 1, 2015 merger.