

Fair Hydro Plan

Communications Plan
September 6, 2017

Communications Approach

In anticipation of the Auditor General's (AG) statements in the Government of Ontario's Public Accounts, and a potential standalone report on the Fair Hydro Plan, the IESO's communications approach tries to take into account the AG's known or expected criticisms of the IESO's accounting policy change to recognize regulatory assets and including the market accounts on its financial statements.

When the province's public accounts are released, it is possible that the IESO will receive media inquiries related to its change in accounting policy, including market accounts on its financial statement, and role in administering the Fair Hydro Plan. The IESO intends to reactively respond to these questions.

The IESO will also take a proactive approach in communicating its position with employees via email.

Current Status:

In early September the Province of Ontario will release its 2016-17 Public Accounts. In that document the AG will make statements regarding the IESO's changes in accounting policy and practices.

This is expected to include the following qualification in her opinion on the 2016-17 consolidated financial statements:

"As described in Note 16c to these consolidated financial statements, the IESO changed its accounting policy and applied it retroactively to recognize market account assets and liabilities. The market accounts track mainly buy and sell transactions between market participants (electricity power generators and power distributors). These market accounts, as recorded on the Province of Ontario's consolidated financial statements are not assets and liabilities of the Province of Ontario. The Government has no access or discretion to use the market account assets for their own benefit, nor does the Government have an obligation to settle the market account liabilities in the event of default by market participants. As a result, Other Assets and Other Liabilities are both overstated by \$1.652 billion (2016- \$1.443 billion). There is no effect on the Consolidated Statement of Operations."

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In her opinion on the 2016-17 consolidated financial statements, the Auditor General (AG) will include an “Other Matter” paragraph, drawing attention to the adoption of rate-regulated accounting by IESO. Her view is expressed as stating PSAS does not permit rate regulated accounting, but that she has not qualified her opinion on this matter because the impact is not material to the 2016-17 consolidated financial statements.

The AG further notes:

“However, the consolidated financial statements may become materially misstated in future periods, as a result of the legislated accounting prescribed under the Ontario Fair Hydro Plan Act, 2017 (Fair Hydro Plan) and its related regulations, as it is not in accordance with Canadian public sector accounting standards.”

IESO’s Position

The IESO disagrees with the Auditor General’s statement that Public Sector Accounting Standards does not permit rate-regulated accounting. Rather, the Public Sector Accounting Standards is silent with respect to rate-regulated accounting.

As a result, when the IESO began working with the provincial government on the development of the Fair Hydro Plan, the IESO consulted US GAAP, the only accounting framework in North America that provides guidance on rate regulated operations prior to making the changes. The IESO has since adopted aspects of the US GAAP accounting framework allowing the IESO to recognize a regulatory asset, bringing it in line with (6 of 8) other independent system operators across North America.

In its role as the market administrator, the IESO operates and settles approximately \$17 billion through the electricity market, where money is constantly flowing to and from market participants, such as consumers and generators. This role requires the IESO to temporarily hold and transfer money between market participants (like Local Distribution Companies and Generators), including recovering costs associated with Global Adjustment. The change to include market account assets and liabilities on our financial statements provides increased transparency around the value of transactions that flow through Ontario’s electricity market. Seven out of the eight other independent system operators in North America recognize the balances of the market participants.

These changes were extensively discussed with our external auditors, the IESO Audit Committee of the Board, as well as the entire Board of Directors. Our external auditors agree with this adoption as does the Office of the Provincial Controller, and have found them to be able to accommodate the implementation of the Fair Hydro Plan. However, the IESO would maintain these accounting changes regardless of government policy

The Board met with the Auditor General on two separate occasions and numerous discussions were held between IESO management and the AG and officials in her office. The IESO and our external auditors thoroughly reviewed the AG's position but ultimately disagreed.

These changes in no way affect the IESO's costs, or the financial impact on electricity ratepayers.

Questions and Answers

1. Why did the IESO adopt rate regulated accounting?

The change to rate regulated accounting better reflects the economic substance of certain types of IESO expenses (like SME expenses) that may not be directly recovered through normal revenue requirement models, and instead recovered through rate regulation. This change is in line with accounting practices followed by other independent system operators in North America.

As a government agency, the IESO regularly works with government around the development and implementation of policy. Throughout considerations to change accounting practices the IESO engaged the Ministry and its external auditors to ensure that any change would be applicable with current and future government policy. The IESO also sought a white paper prepared by our auditors at KPMG to ensure it would be able to accommodate current and future government policy.

The change to rate regulated accounting enables more transparency around the IESO's right to collect the deferred costs described in the Fair Hydro Plan, in the future. However, the IESO would maintain this accounting change regardless of government policy.

2. If the accounting standard used by public sector entities (PSAS) does not allow for regulatory accounting, how can the IESO recognize regulatory assets?

PSAS neither explicitly permits, nor prohibits, the recognition, measurement, presentation or disclosure of rate-regulated activities. In absence of a clear position on an issue, standard accounting practice dictates that an entity is entitled to consult another accounting standard. In this case, the IESO consulted US GAAP, the only accounting framework in North America that provides guidance on rate regulated operations. The IESO has since adopted aspects of the US GAAP accounting framework allowing the IESO to recognize a regulatory asset. This decision was supported by an accounting opinion from our external auditors at KPMG and aligns the IESO with six of the eight other independent system operators in North America.

3. How does the IESO's accounting policy fit with the government's global adjustment refinancing plan?

The IESO can recognize a regulatory asset related to the variance account created by the Act. The accounting opinion issued by KPMG to the IESO confirms our view that the accounting practices and structures in the Fair Hydro Act, 2017 are consistent and compatible with the IESO's current financial accounting practices. As a result, the IESO can recognize a regulatory asset related to the right to recover the balance in the variance account created by the Act, and that regulatory asset will no longer be included in IESO financial statements upon transfer of the regulatory asset to a financing entity.

4. The AG states that the IESO would be the only government organization in Canada to have recorded regulatory assets on its PSAS-based financial statements.

The IESO is not aware of any other Canadian entities recognizing regulatory accounting, under PSAS. However, using rate regulated accounting brings the IESO in line with (6 of 8) other independent system operators across North America.

5. What steps did the IESO take to verify that the accounting changes were appropriate for the organization?

- IESO senior management considered accounting policy changes to increase transparency of its \$17B annual market transactions, the substance of the variance accounts it holds and its right to collect an amount in the future.
- IESO engaged KPMG for accounting research to support their advice and guidance on our accounting policy change. They noted six other system operators in North America that use regulatory accounting.
- KPMG issued a white paper, supporting the IESO's decision to change its accounting policy.
- The accounting change was reviewed by the IESO Board, and approved.
- The IESO reached out to the OAG to communicate the change and met with the AG several times to discuss her views. The Auditor General also subsequently met on two separate occasions with the IESO Board of Directors.
- KPMG issued another accounting opinion on IESO's use of rate regulated accounting, supporting the IESO's decision.

6. When did the IESO make the decision to adopt rate regulated accounting?

The IESO adopted its new accounting practices on March 15, 2017 after discussions with our external auditors at KPMG, and the IESO Board.

7. Why did the IESO rush to implement its new accounting policies in March and redo the financial statements for the 2016 fiscal year?

The decision to adopt the new accounting policies was made when the IESO was in the process of finalizing its 2016 financial statements. Therefore, it made sense to make the change and reflect it this year.

8. Were you already in discussions with the government around their Fair Hydro Plan when IESO made the decision to adopt rate regulated accounting?

Yes. The IESO is a government agency and works regularly with the Ministry of Energy on the development and implementation of various government policies affecting Ontario's electricity sector - the Fair Hydro Plan is no different.

9. Was the impetus for the IESO to change its accounting practices a result of discussions with government around the implementation of the Fair Hydro Plan?

There were a number of factors in play at the time the decision was made to change our accounting practices.

As a government agency, the IESO regularly works with government around the development and implementation of policy. Throughout considerations to change accounting practices the IESO engaged the Ministry and its external auditors to ensure that any change would be applicable with current and future government policy. The IESO also sought a white paper prepared by our auditors at KPMG to ensure it would be able to accommodate current and future government policy.

However, the IESO would maintain these accounting changes regardless of government policy. Rate regulated accounting is recognized by several (6 of 8) other independent system operators in North America and the introduction of market account assets and liabilities on our financial statements provides increased transparency around the value of transactions that flow through Ontario's \$17 billion electricity market. Seven out of the eight other independent system operators in North America recognize the balances of the market participants.

These changes in no way affect the IESO's costs, or the financial impact on electricity ratepayers.

10. Would the government have been able to implement their Fair Hydro Plan without having the IESO change its accounting practices to rate regulated accounting?

You'd need to speak with the government.

11. Is the IESO truly independent if it is willing to change its accounting practices to ensure consistency with government policy?

As a government agency, the IESO regularly works with government around the development and implementation of policy. Throughout considerations to change accounting practices the IESO engaged the Ministry and its external auditors to ensure that any change would be able to accommodate current and future government policy.

However, the IESO would maintain these accounting changes regardless of government policy. These changes enable more transparency around the value of transactions that flow through Ontario's \$17 billion electricity market and seven out of the eight other independent system operators in North America recognize the balances of the market participants.

12. How much did the IESO spend on accounting and legal advice related to the Fair Hydro Plan?

There were a significant number of legal and accounting considerations that were required to properly understand the implications of the FHP. The IESO used outside services of a legal firm and an accounting firm to support the internal analysis and ensure appropriate due diligence:

- KPMG: approximately \$300K as of July 20, 2017
- Stikeman Elliott: approximately \$230K as of July 20, 2017

13. How does reporting Ontario's energy market accounts increase transparency?

The change allows for greater transparency into the value of transactions facilitated through the IESO-administered market. These market accounts are largely made up of the payments to generators and other market participants, from Local Distribution Companies and consumers, but also include cash that is restricted for market activities (transmission rights, adjustment account, held in-trust) line of credit and other liabilities. This change brings the IESO in line with seven out of the eight other independent system operators in North America.

The IESO operates and settles approximately \$17 billion through the electricity market, where money is constantly flowing to and from market participants, such as consumers and

generators. This role requires the IESO to temporarily hold and transfer money between market participants (like Local Distribution Companies and Generators). The change to include market account assets and liabilities on our financial statements provides increased transparency around the value of those transactions.

The change was made to better reflect the assets and liabilities and amounts due to and from market participants held by the IESO on behalf of the IESO-administered market at year-end.

14. Why didn't the IESO include these transactions on financial statements prior to 2016?

The IESO regularly reviews its accounting policies. Working with its auditor, the IESO determined that there were reporting options for market accounts and that a choice is required as to whether or not to record Market Accounts assets and liabilities in the IESO financial statements. By analyzing the nature of the accounts, IESO's economic relationship to them, legislative requirements and market rules it was concluded that an appropriate position for either treatment was acceptable.

Ultimately, the IESO feels the public reporting of market accounts is relevant to the needs of its financial statement users and enables greater transparency into the market transactions it oversees, which amounted to \$17 billion last year.