Auditor General's Annual Report
Chapter 2: Public Accounts

The Auditor General's upcoming annual report will feature a section on Public Accounts that discusses the government's Fair Hydro Plan, including the IESO's change in accounting policy. Within that section of the report is a recommendation for the IESO.

Recommendation #5: We recommend that the Independent Electricity System Operator (IESO), an "other government organization," use the Canadian Public Sector Accounting Standards (PSAS) in the preparation of its financial statements. Specifically, it should:

- *Remove market accounts recorded on its financial statements; and*
- *Discontinue the inappropriate use of rate-regulated accounting in the preparation of its financial statements.*

To ensure that the members of the Legislative Assembly receive financial information on the operations of the IESO prepared in accordance with Canadian PSAS, the Office of the Auditor General will conduct an attest audit of the December 31, 2017, financial statements of the IESO as permitted under the Electricity Act, Subsection 25.2(2), which states: "The Auditor General may audit the accounts and transactions of the IESO. 2014, c.7, Sched. 7, s. 3 (1)."

Key Messages

- The IESO is a rate-regulated entity, as defined by the OEB and can recognize regulatory accounting.
- The IESO believes that the recognition of regulatory assets and liabilities better reflects the economic substance of the IESO's operations and enhances the relevance, transparency and accountability of its financial reporting.
- Using rate regulated accounting brings the IESO in line with 6 of 8 other independent system operators across North America.
- The IESO and its external auditor agree, 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 change to recognize regulatory accounting in no way affects the IESO's costs, or the financial impact on electricity ratepayers.

In addition to the recommendation, the Auditor General makes several statements in the report that the IESO feels are either incorrect or are mischaracterizations. The IESO's responses to these recurrent themes are below.

AG statement 1: "The IESO is not a rate-regulated entity." (p.21)

Response: As described by the OEB, the IESO is a rate-regulated entity. In a recent OEB Report *Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs*, the OEB claims, and the IESO agrees, that it is in fact a rate-regulated entity and therefore can recognize rate-regulated accounting:

"The OEB is of the view that the IESO is a rate-regulated entity and the extent that the mechanism established in this Report (or an alternative mechanism that meets the spirit of this policy) should apply to the IESO will be reviewed and determined in the IESO's next fees case" (page 9, note 4).

AG statement 2: "The market accounts recorded on the IESO's financial statements do not meet the definitions of an asset or liability within Canadian PSAS." (p.17)

Response: In her report, the Auditor General assumes that the market accounts include only transactions settled through the electricity market – to which the IESO is not counterparty and bears no risk in the case of a payment default. In fact, the market accounts reflected on the IESO's financial statement also include the settlement of accounts defined by legislation and regulation, for example, variance accounts such as: Fair Hydro Plan, RRRP, and OESP. These market accounts include those the IESO would need to borrow in order to settle in the case of default. Because of this, the IESO feels, and its external auditor agrees, that these market accounts do in fact meet the PSAS definition of assets and liabilities and are appropriately reported in its financial statements.

AG statement 3: "Except for 'Government Business Enterprises', rate-regulation does not apply to the public sector." (p.24)

Response: The IESO and its external auditor agree that PSAS neither explicitly permits, nor prohibits, the recognition, measurement presentation or disclosure of rate-regulated activities and the IESO believes that the recognition of regulatory assets and liabilities better reflect the economic substance of its operations and enhances the relevance, transparency and accountability of its financial reporting.

AG statement 4: "…management and the IESO auditor were aware that there was a risk that our Office would not accept the proposed rate-regulated accounting policy change… The Audit Committee initially asked management to discuss these accounting policies with the Auditor General, but we were never contacted." (p.33)

Response: The IESO 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.