Questions and Answers for Estimates Committee

(Part 1)

1. **We understand that the IESO My understanding is that through a regular review of its accounting practices, the IESO recently made a decision to change its accounting policy. What does this mean?**

The Independent Electricity System Operator is the public agency that plans for and operates the provincial power system and administers the wholesale electricity market. Through this market, money is constantly flowing to and from market participants, such as consumers and generators. In our role as the market administrator, we settle these transactions, which in 2016 were worth approximately $17 billion dollars. The substance of these transactions was previously unreported on the IESO's financial statements.

The IESO also incurs certain expenses related to Ontario's electricity system that are not directly recovered through normal revenue requirement models, and instead are recovered through rate-regulation. For example, the IESO is designated as Ontario's Smart Metering Entity. In its role as the Smart Metering Entity, the IESO is responsible for the implementation, integration and operation of province's Metering Data Management/Repository (MDM/R), the repository where data from smart meters across the province is stored. The costs associated with the IESO's role as the Smart Metering Entity are recovered through the Smart Metering Charge, a charge approved/regulated by the OEB. The IESO's assets and liabilities as the Smart Metering Entity were previously unreported on its financial statements.

The IESO regularly reviews its accounting policies to ensure that they provide transparent and relevant financial reporting that most accurately represents the IESO's assets and liabilities and meets the needs of its financial statement users. Through a recent review with our external auditor – accounting firm, KPMG – the IESO determined that there were reporting options for market accounts and rate-regulated assets and that a choice was required as to whether or not to report these in the IESO financial statements.

After thorough consideration with IESO senior management and Board and engagement with our external auditors, the IESO decided to implement two changes to its accounting policy: First, to record the market accounts assets and liabilities and amounts due to and from market participants held on behalf of the IESO-administered markets in its statement of financial position, and second, to recognize regulatory assets.

Back in 2016, the IESO started looking into the possibility of changing its accounting policy to better reflect the economic substance of certain types of IESO expenses and to provide greater transparency into the value of electricity market transactions. – like our Smart Metering Entity expenses, and to provide greater transparency into the $17 billion in electricity market transactions, which the IESO oversees.

The IESO consulted with its external auditors, KPMG who offered an unqualified opinion on the change – meaning KPMG audited and ultimately supported the decision.

2. **Why did the IESO change its accounting policy?**

The IESO made the change to its accounting policy to provide greater transparency into Ontario's $17 billion electricity market and to better reflect the economic substance of certain types of IESO expenses (like those related to the Smart Metering Entity) that may not be recovered directly through normal revenue requirement models, and instead are recovered through rate regulation. Previously, both of these were unreported on the IESO's financial statements.

This change to recognize regulated assets and market account assets and liabilities brings the IESO in line with accounting practices followed by other independent system operators in North America.

3. **So we're talking about changes to your financial statements to recognize assets and liabilities that are part of the IESO's operations, but previously went unrecorded in your year-end statements. What steps did the IESO take to verify that the accounting changes were appropriate for the organization? Did you consult with any third parties on the issue?**

First, the IESO's senior management team considered the 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 – as with regulatory assets.

To confirm that the change was appropriate, the IESO engaged KPMG for accounting research to support their advice and guidance on our accounting policy change. They noted six of eight other system operators in North America that use regulatory accounting and seven out of eight system operators in North America recognize the balances of the market participants.

Then, KPMG issued a white paper on the accounting change, supporting the IESO's decision to change its accounting policy. The changes were also reviewed with and supported by the Office of the Provincial Controller.

The accounting change was reviewed by the IESO's Board of Directors, and approved.

Following this, the IESO engaged KPMG to issue its accounting opinion on the issue. The accounting firm issued an unqualified accounting opinion, meaning they supported the decision.

In order to communicate the change of accounting policy, the IESO added additional notes in its 2016 financial statements to explain the changes in the Summary of Significant Accounting Policies section of its 2016 annual report.

4. **Regulated assets and market accounts. These sound like the types of assets and liabilities all independent system operators would have. How does the IESO's accounting policy compare to its peers in this regard?**

In addition to the IESO, there are eight other independent system operators in North America. The accounting policy change implemented by the IESO brings it in line with most of its peers.

Six out of eight other independent system operators in North America currently recognize regulatory assets. Seven out of eight recognize the balances of market participants.

5. **I think many people will want to know how this change will impact them, as electricity rate payers. Can you tell us if and how this change impacts the province's rate payers?**

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

Ultimately, the IESO made these changes because it will provide the users of its financial statements greater transparency into the market transactions it oversees, which amounted to $17 billion last year, and better reflects the economic substance of IESO expenses that are recovered through rate regulation.

(Part 2)

6. **Was the IESO directed by the government to make this accounting change?**

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.

7. **Did the IESO make this accounting change to accommodate the Fair Hydro Plan?**

As a government agency, we work closely with the government on the development and implementation of policy. In making this accounting change, we consulted with government and its external auditors to make sure that any change would be applicable to current and future policy. We sought a white paper by our auditors to ensure the new accounting policy would accommodate current and contemplated policy.

8. **But isn't it true that under your old accounting policy, the IESO would not have been able to recognize the regulatory asset its now required to recognize under the Fair hydro Plan Act?**