Standing Committee on Public Accounts: Key Messages and Q&As

Rationale for change

1. **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).
    - Also included in the IESO's "Market Accounts" are accounts that are settled through legislation and regulation, for example, variance accounts such as: OESP, RRRP and the Fair Hydro Plan. These accounts are not subject to the market rules.
    - The change to include market account assets and liabilities on our financial statements provides increased transparency around the value of those market accounts.

2. **What steps did the IESO take to determine whether regulatory accounting was appropriate for its financial reporting?**
    - 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.
    - These changes were extensively discussed with our external auditors, the IESO Audit Committee of the Board, as well as the entire Board of Directors.

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- Our external auditors agreed with this adoption as did 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.

- 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 several 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.

Regulatory Accounting Under PSAS

3. The AG has stated her disapproval with the IESO's accounting change, saying that the IESO would be the only government organization in Canada to have recorded regulatory assets on its PSAS-based financial statements. How do you respond to this?

- 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.

4. The Auditor General claims the IESO cannot adopt regulatory accounting under US GAAP, because the OEB is not an independent regulator.

- The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (the Electricity Act") and the Ontario Energy Board ("OEB") Act, 1998 (the "OEB Act"). The IESO activities subject to rate regulation by the OEB include the following:
  (a) IESO's expenditure, revenue requirements and fees;
  (b) Smart metering activities; and
  (c) A subset of market accounts.

5. **How did the IESO come to the conclusion that it was acceptable to look to US GAAP for guidance on rate regulated activities? Is there a clause or section of PSAS that permits the use of GAAP in a given scenario?**

- The IESO follows Public Sector Accounting Standards (PSAS) for its accounting.
- 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.
- If I may cite from the PSAS Handbook, Section 1150.18 and 19:

> *"Paragraphs PS 1150.19-.24 identify some of the other sources that a public sector reporting entity might consult to assist in selecting accounting policies and disclosures that comply with paragraph PS 1150.05.Pronouncements issued by other bodies authorized to issue accounting standards may be useful sources to consult. For example, accounting pronouncements published with the authority of the Canadian Accounting Standards Board (AcSB), International Accounting Standards Board (IASB), US Federal Accounting Standards Advisory Board (FASAB), US Governmental Accounting Standards Board (GASB), or International Public Sector Accounting Standards Board (IPSASB) are often important sources to consult on matters not covered by primary sources of GAAP or for assistance in applying a primary source of GAAP to specific circumstances."*

- 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 as we've just discussed, aligns the IESO with six of the eight other independent system operators in North America.
- In fact, more than one of the big-four accounting firms agree with our decision on this matter.

If pressed on "other accounting firm", a reference can be made to the Deloitte Report only when accompanied by the following statement, in its entirety:

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"KPMG is the auditor of the IESO. Deloitte was engaged by KPMG to provide its opinion (the "Deloitte Report") on whether a public sector entity could use rate regulated accounting under Canadian Public Sector Accounting Standards ("PSAS"), as established by CPA Canada.

PSAS are silent on the question of how to account for the impacts of rate regulation. Through an analysis of the guidance provided in PSAS, the Deloitte Report concluded that it is appropriate for a public sector entity to select accounting policies that would result in the recognition of the impacts of rate regulation, by analogy to US accounting standards and the related eligibility criteria on the topic. The Deloitte report further concluded that any regulatory assets and liabilities recognized through the appropriate application of these policies would meet the criteria for recognition under PSAS.

It should be noted, however, that the Deloitte Report did not include in its scope an assessment of the specific regulatory assets or liabilities recognized by the IESO through the application of this accounting policy under PSAS."

Timeline

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. 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.

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

- The IESO regularly reviews its accounting policies.
- Prompted by a discussion with government about the Fair Hydro Plan, the IESO revisited its options for reporting market accounts and recognizing regulatory assets.
- Working with its auditor, the IESO determined that a choice was required as to whether or not to record Market Accounts and regulatory 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.
- In order to confirm our decision, we asked KPMG to conduct some research on our behalf into the appropriateness of adopting regulated accounting.
- Their research agreed with our view that the recognition of regulatory assets and liabilities better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting.
- It also found that US GAAP was an appropriate accounting framework to look to for guidance on rate-regulated operations, since PSAS was silent on the issue. And that regulatory assets under ASC 980 is not an exemption from the application of US GAAP.
- Finally, KPMG found that the accounting change would bring the IESO in line with the majority of its ISO peers across North America.
- When we considered the results of KPMG's research, along with the fact that the change would have no impact on **the IESO's costs, or have any financial impact on electricity ratepayers, we went ahead and made the accounting change.**

If pressed: **But isn't it true you revised your 2016 financial statements only once the Fair Hydro Plan financing structure was decided upon?**

- o As a government agency, we work closely with government on a regular basis. In contemplating the accounting policy change, we consulted with government and our external auditors to ensure that any change would be applicable with current and future government policy.
- o The IESO also sought a white paper prepared by our auditors at KPMG to ensure it would able to accommodate current and future government policy.

9. Why did the IESO defer the discussion of its 2016 financial statement with its Board?

- The IESO regularly reviews its accounting policies.
- The IESO's "audit plan" – the schedule to review and approve the IESO's financial statements with our Board – is set in October of the previous year.
- Leading up to the date scheduled to review the financial statements with the Board, discussions were still taking place around the IESO's recognition of regulatory accounting.

- Recognizing that the addition of regulatory accounting required an expanded audit scope, Board asked management to undertake further work and report back with a recommendation, delaying the review and approval.

KPMG consultation:

- During this time, the IESO engaged KPMG to conduct research into appropriateness of regulatory accounting in the IESO's financial reporting.
- Given that PSAS is silent on regulatory assets, KPMG looked at what accounting framework in North America should be consulted for guidance on rate-regulated operations. They concluded that US GAAP was an appropriate framework to consult.
- The accounting firm looked at other similar entities to the IESO, to determine:
    1) If they served as relevant comparisons to the IESO on the issue and
    2) How these entities treated market accounts and regulatory assets in their financial reporting.

At the completion of its research, KPMG concurred with IESO:

- That the recognition of regulatory assets and liabilities better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting.
- In absence of clear directions from PSAS, that US GAAP was the only accounting framework in North America that provides detailed guidance on rate-regulated operations

Other discussions:

- We also discussed the change with the Provincial Controller's office to ensure this change aligned with future policy.
- We reached out to the Auditor General and met on several occasions to discuss the change.

The IESO ultimately felt that:

- The adoption of regulatory accounting allowed for financial reporting that was more relevant to the needs of its financial statement users and enabled greater transparency into the market transactions it oversees, which amounted to $17 billion last year.
- We also felt that recognizing regulatory assets would provide more transparency into the substance of the variance accounts we oversee.
- This change also brought the IESO in line with the accounting policies of other independent system operators in North America.

- Given that the change had no impact on the IESO's costs, or any financial impact on ratepayers, we went ahead and made the accounting change.

Independence

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

- The IESO is an independent agency of the Government of Ontario. We value this independence and have a history that is reflective of our commitment to it.
- Independence, however, does not mean isolation.
- 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.

11. 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.
- However, the IESO would maintain these accounting changes regardless of government policy.

12. 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 our 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.
- Had the Fair Hydro Plan never come into effect, the IESO would still maintain these changes.

13. **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?**
    - The discussion surrounding the IESO's accounting policies were sparked by a conversation with government. But had the proposed legislation not passed, we would have still maintained these changes.
    - Six of 8 other independent system operators in North America recognize regulatory accounting and better reflects the substance of the accounts we oversee.
    - Seven of 8 other independent system operators in North America recognize the balances of the market participants. 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.

14. **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.

15. **Would the IESO have been able to help facilitate the Fair Hydro Plan through its accounting if you hadn't made the change?**
    - You would have to speak with the government about other financing options that were under consideration for the Act.
    - But the IESO would have gone ahead with these changes to its accounting policy, even if the policy had not.

16. **Who, in your opinion, developed the accounting scheme behind the Fair Hydro Plan?**
    - I can't comment on the government's accounting policies, but I can tell you that we worked closely with our auditors to ensure that any change would be applicable with current and future government policy.

17. **It appears the Fair Hydro Plan accounting structure was designed around a preferred outcome: to keep the costs involved off the provincial books. What was the IESO's role in this?**

- You'd have to speak with government about this.
- I can tell you the IESO considered these accounting changes carefully, on their own merits: they introduce greater transparency into the IESO's financial reporting and aligns us with other system operators in North America
- Had the Fair Hydro Plan not gone ahead, we would have maintained this accounting change anyway.

External Advice

18. **Who was involved in the decision making process? What experts and outside companies were involved, and is the IESO certain that they left no stone unturned in ensuring the proper accounting process and standards were chosen?**

- It's a decision we made after careful consideration and extensive consultation with external experts.
- The IESO regularly reviews its accounting policies to ensure our financial reporting best represents our operations and the substance of the accounts we oversee.
- Prompted by conversation with government about the Fair Hydro Plan and recognizing the need to consider impacts of future government policy, the IESO revisited its options for reporting market accounts and recognizing regulatory assets.
- Working with its audit partner KPMG, the IESO determined that there were reporting options for market accounts and regulatory assets and that a choice was required as to whether or not to report these 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 felt the public reporting of market accounts was relevant to the needs of its financial statement users and enabled greater transparency into the market transactions it oversees, which amounted to $17 billion last year.
- We also felt that recognizing regulatory assets would provide more transparency into the substance of the variance accounts we oversee.

- This change to recognize regulated assets and market accounts brings the IESO in line with accounting practices followed by other independent system operators in North America.
- I should also mention, that in the past, the Ontario Power Authority, a predecessor organization of the IESO, reported a subset of the market accounts on its financial statements – so this isn't new.
- To confirm our view that the change was appropriate, the IESO engaged independent audit firm KPMG for accounting research on the matter.
- KPMG conducted their own research into the issue.
- KPMG's research supported 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.
- As part of our regular 2016 year-end audit, KPMG issued an accounting opinion on our financial reporting. The accounting firm issued an unqualified or "clean" accounting opinion, meaning they supported the decision.
- Following this, the IESO reached out to the Office of the Auditor General to discuss the accounting policy change. 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.
- Finally, when publishing our 2016 financial statements, 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.
- **When finalizing our decision, we considered that these changes in no way affect the IESO's costs, or have any 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 amounts to approximately $17 billion, and better reflects the economic substance of IESO expenses that are recovered through rate-regulation.

19. You say the IESO received an "unqualified opinion" from its auditor on your 2016 financial statements. What does that mean?

- It is the auditor's responsibility to express an opinion on the financial statements based on their audit.

- In our case, KPMG conducted their audit in accordance with Canadian generally accepted accounting standards.
- Those accounting standards require that the auditors comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the entity's financial statements are free from material misstatement.
- Here are some of the things an audit looks into:
- An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.
- The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.
- In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
- **On our 2016 financial statements, KPMG stated: "We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion"**
- This was followed by a statement of their **unqualified opinion**:
    - **In our opinion, the financial statements present fairly, in all material respects, the financial position of the IESO as at December 31, 2016, and its results of operations and the changes in its new debt and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.**
- This is taken directly from our 2016 financial statements, which are publically available.
- So the "unqualified opinion" is basically accounting-speak to say that the audit partner undertook the thorough audit process, applied the appropriate standards and believes the financial statements follow the appropriate accounting standard and fairly and accurately represent the IESO's financial position at year-end.

20. 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 $440K as of Feb 22, 2018
- Stikeman Elliott: approximately $250K as of Feb 22, 2018