Memorandum

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To: THE BOARD OF DIRECTORS
of the Independent Electricity System Operator

From: Susan Nicholson
Corporate Controller

Date: July 25, 2017

Re: Fair Hydro Plan – Accounting Policy Change Analysis

The recognition of the market accounts assets and liabilities on the statement of financial position was effective for 2016 and the accounts have been included in the first quarter statutory statements that were published on our internet site as of May 31, 2017. The balances of the market accounts are shown not only on the face of the statement, but are also detailed by account in Note 2. These statements and notes have been appended for your information.

The introduction of the Fair Hydro Plan (FHP) results in a number of changes to the market accounts. The accounting for these changes is already underway as some of these program changes were effective on May 1, 2017.

The changes to the Rate Regulated Plan (RPP) or Global Adjustment smoothing are by far the largest changes to our accounting but the FHP will also change the Rural or Remote electricity Rate Protection (RRRP) program to provide distribution charge relief for the customers of the costliest LDCs. It will enhance the Ontario Electricity Support Program (OESP) and work to ensure the program uptake is as close as possible to 100%. And it will establish a new First Nations On-Reserve Delivery Credit.

The changes to the OESP are designed to expand eligibility and increase credits to cover more low income Ontarians and became effective May 1, 2017. Although the OESP will eventually be funded by the provincial revenues, the initial funding from the IESO will come from the OESP variance account in the market books. The balance in the variance account was a liability $110.9 million as of March 31, 2017 (see attached appendix – Note 2 Market Accounts).

The changes to the RRRP will split the current program into three programs, two of which will be paid by provincial revenues and the third will be paid through a new RRRP rate. The new RRRP rate was effective on July 1, 2017. The variance account for RRRP will continue but only for the portion of the program that is financed through the rate set by the Ontario Energy Board (OEB). The portion that will be paid through provincial revenues will be settled in same invoicing period and therefore will not impact the variance account. The balance in the variance account was a liability of $2.7 million as of March 31, 2017 (see attached appendix – Note 2 Market Accounts).

The First Nations On-Reserve Delivery Credit is part of the vulnerable consumer programs and started on July 1. The program will be paid through provincial revenue and settled in the same invoicing period resulting in no new variance account on the IESO market books.

Although a reduced RPP rate was introduced on May 1, 2017, the actual changes for the RPP or Global Adjustment smoothing program were effective on July 1, 2017, as per the OEB's Decision and Order dated June 22, 2017. Many of the accounting changes expected from this change will commence in September with the first transfer of the variance account to the financing entity (OPG Trust). The accounting for these transactions will be as follows each month:

1) IESO will pay the generators the complete amount owed and the IESO will receive a reduced amount (RPP and Non-RPP's global adjustment modifier) from the LDCs.
2) The Financing Entity will invoice the IESO for any Financing Entity expenses including any OPG administration costs, third party vendor costs and interest during the four year moratorium period (prior to the Clean Energy Adjustment coming in effect).
3) The LDC shortfall and Financing Entity expenses will be funded by IESO in the interim via debt facilities and will be recorded as part of a regulatory asset. This regulatory asset represents the right to be reimbursed for these costs in the future.
4) The Financing Entity will purchase the regulatory asset. This will transfer the risks and rewards associated with the regulatory asset from the IESO to the Financing Entity.
5) IESO will use the cash received from the transfer of the regulatory asset to repay the debt from step 3 above.
6) Any interest incurred by the IESO for debt will also be recorded in the variance account as part of the regulatory asset and recovered in a subsequent transfer of the regulatory asset.
7) If there is any remaining balance in the IESO's regulatory asset after the moratorium period, it will then become recoverable from the market.

The transfer of 100% of the regulatory asset to the Financing Entity will not add any additional variance amounts on the market books at each month end. The balance in the variance account as of March 31, 2017 was an asset of $72.4 million (including interest) and offset by the revolving line of credit (see attached appendix – Note 2 Market Accounts). The change in the market accounts from "variance account" to "regulatory asset" will be made effective July 1, 2017 consistent with the OEB Decision and Order.