Memorandum

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

From: Kim Marshall
VP Corporate Services and CFO

Date: July 25, 2017

Re: Fair Hydro Plan Accounting Risk

The purpose of this memorandum is to discuss potential actions of the Office of the Auditor General (OAG) regarding the Fair Hydro Plan (FHP) accounting issues. The actions are:

- Qualified opinion on the Province financial statements for the year ending Mar 31, 2017.
- Chapter 2 comments in the annual report to be issued late in 2017, even if not connected to a qualification.
- Professional misconduct complaint to the CPA of Ontario.

Below is some detail regarding the actions, along with IESO plans to mitigate.

1. **Qualified Opinion on the Province Financial Statements**

For the prior year ended March 31, 2016, the OAG issued a qualified opinion on the Provincial financial statement related to the treatment of pension assets. Exhibit A provides the first several pages of Chapter 2 of the 2016 OAG annual report which was issued in late November 2016. This contains the Audit Qualification notice and gives an example of the tone and language regarding a qualification. It is expected that the pension issue continues for the financial statements for the year ended March 31, 2017. A link to the entire OAG annual report and Chapter 2 report is here:

http://www.auditor.on.ca/en/content/annualreports/arbyyear/ar2016.html

The dollar amount of the 2016 IESO financial statements changes is not material to the Province financial statements. However, it is likely that a qualified opinion for the year ending March 31, 2016 will refer to the IESO accounting policy changes. The OAG provides the Provincial Controllers' office with an annual audit planning memo. Exhibit B provides extracts of the audit planning memo which relate to the IESO. These items were brought to attention of IESO Management. The IESO will need to be prepared to respond to inquiries in late August, when the audit is complete, and in December when the OAG annual report is issued.

The Province can change any financial statement presentation upon consolidation. The impact of the FHP will appear in the financial statements for the year ending March 31, 2018. IESO management will continue to have discussions with KPMG and the Provincial Controller and will keep the Board informed

Risk Mitigation Actions

IESO management will continue to communicate with the Provincial Controller Office and the Ministry of Energy. An IESO response will be prepared and shared with the Board.

2. Chapter 2 of the OAG Annual Report

The IESO change in accounting policy may not be considered material to the Province financial statements for the year ended March 31, 2017. Chapter 2 of the OAG annual report provides an opportunity for the office to identify additional issues within the Public Accounts. A sample of material from the 2016 OAG report is shown in Exhibit C.

On the pension issue mentioned above, both the Provincial Government and the OAG, presented expert opinions supporting each of their approaches. Exhibit D is a newspaper article discussing the issue, as an example of the type of press coverage this dispute received.

Risk Mitigation Actions

IESO continues to work with KPMG and the Provincial Controller's Office to ensure supporting materials are available if needed.

3. Professional misconduct complaint to the CPA of Ontario

The OAG has verbally alleged misconduct, although nothing has been provided in writing to IESO or KPMG. CPA Ontario has a Code of Conduct and process of investigation that would be followed in the event of a complaint. The IESO is ensuring documentation is available regarding process and actions taken.

As part of this documentation, attached Exhibit E is an attestation from the Chief Risk Officer at KPMG to their independence, stating actions they have taken to assure themselves of their independence and with reference to the CPA Ontario code of conduct.

Risk Mitigation Actions

IESO will continue to monitor this risk.