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Independent Electricity System Operator

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Memorandum

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

From: Susan Nicholson
Corporate Controller

Date: March 17, 2015

Re: Item 5 - Accounting Standards and Statutory Financial Statements

The merger of the Independent Electricity System Operator (IESO) and the Ontario Power Authority (OPA) created a need to establish one accounting standard for the amalgamated entity (IESO).

BACKGROUND

Pre-merger Standards
Prior to the merger, IESO and OPA followed different accounting standards. IESO followed Public Sector Accounting Standard Board (PSA) standards for government organizations as an Other Government Organization (OGO) whereas OPA followed PSA standards plus the 4200 series of CPA Canada Public Sector Accounting Handbook standards applicable to government not-for-profit organizations (GNFPO).

The main users of the amalgamated IESO financial statements will be the Ministry, OEFC and banks, OEB, and the provincial controller's office. Either standard would satisfy the needs of our financial statements users. The recommended standard aligns with the Province's accounting policy and consolidation requirements.

RATIONALE

Type of Government Enterprise
In determining what standard should be applied to IESO, we evaluated our organization type. The different types of organizations are summarized in the table below.

The activities of the amalgamated IESO are heavily characterized by the market operations. Based on a review of Canadian and select American system operators (Alberta, New York, New England), none of these entities meet the tests above as private counterparties. As such, IESO will be considered an OGO and will not qualify as a GNFPO. This is consistent with the organization type of the pre-merger IESO.

RECOMMENDATION

PSAB or IFRS

The IESO should adopt PSA standards, excluding section 4200.

OGOs have a choice of adopting either PSA standards or IFRS. If an OGO considers itself a publicly accountable enterprise (e.g. LCBO) then it could voluntarily adopt IFRS. Otherwise, an OGO should adopt PSA standards. The IESO is not an independent publicly accountable enterprise and therefore it should adopt PSA standards.

In recent discussions with both the Office of the Provincial Controller and our external auditors KPMG, there was agreement that PSA standards are the most applicable for the IESO.

Government Organization	Description	Accounting Standards
Government	• Federal, provincial, territorial & local governments	PSA standards
Government business enterprises (GBEs)	• Separate legal entity; • Delegated financial and operational authority; • Sells goods & services outside the reporting entity; and • Can maintain operations & meet liabilities from revenues received from outside the reporting entity	International Financial Reporting Standards (IFRS)
Government not-for-profit organizations (GNFPO)	• Normally without transferable ownership interests; • Organized & operated exclusively for a not-for-profit purpose; and • Has counterparts outside the public sector	PSA including section 4200
Other government organizations (OGOs)	• Is not a government; and • Does not meet the criteria of a GBE, or GNFPO	PSA standards or IFRS

IMPACT ON FINANCIAL REPORTING

It was noted at the Audit Committee meeting in February that the financial statement presentation was different between the pre-merger organizations. The presentation of the pre-merger IESO financial statements and notes are aligned with the recommended PSA standards.

Highlights of some major difference in PSA Standards in comparison to PSA +4200 formerly used by the OPA:

	PSA Standards
Statement of financial position	o Net debt[1] is derived from the net of financial assets[2] and liabilities o Accumulated surplus or deficit resulted from sum of net debt and non-financial assets[3]
Statement of Operations	o Budget is required to be presented o Expenses reported by segment with disclosure of expenses by object (type). o Accumulated surplus is presented by sum of current year net income and previous year's accumulated surplus balance
Statement of changes in net debt	o Prior year balance and budget are required to be presented
Statement of cash flows	o Separate capital activities are presented

The attachment below shows the "unaudited" opening statement of financial position for the amalgamated entity as of January 1, 2015, including the adjusting entries to remove market transactions relating to the Global Adjustment and to increase the Other Post-Employment Benefit (OPEB) liability in accordance with the actuarial calculation.

As discussed in February, the market transactions relating to Global Adjustment will be moved to the market accounting process and the reporting of these transactions will be captured within the Monthly Market Report, which will provide transparency on this information. This removes these transactions from the corporate assets and liabilities. It is also in line with one of the significant accounting policies of the pre-merger IESO which is the "financial statements do not include the financial transactions of market participants with the IESO-administered markets."

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[1] Net debt provides a measure of the future revenues required to pay for past transactions and events.
[2] Financial assets are defined as "assets that could be used to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations."
[3] Non-financial asset is any asset acquired, constructed or developed that does not normally provide resources to discharge existing liabilities, but:

- Is normally employed to delivered government services;
- May be consumed in the normal course of operations.
- Is not for sale in the normal course of operations.

The attached statement of operations and accumulated deficit depicts the amalgamated entity using the December 31, 2014 financial information and presents expenses by object within each segment.

Susan Nicholson

Attachment

ATTACHMENT

Independent Electricity System Operator
Statement of Financial Position (unaudited)
As at (in thousands of Canadian dollars)

	IESO Dec. 31, 2014	OPA Dec. 31, 2014	Adjusting Entries	IESO Jan. 1, 2015
FINANCIAL ASSETS				
Cash and cash equivalents	11,886	138,812	(42,036)	108,662
Accounts receivable	17,813	539,485	(538,700)[4]	18,598
Long-term investments	33,979	-	-	33,979
TOTAL FINANCIAL ASSETS	**63,678**	**678,297**	**(580,736)**	**161,239**
LIABILITIES				
Accounts payable and accrued liabilities	25,862	479,889	(398,809)[5]	106,942
Accrued interest on debt	364	-	-	364
Deferred rent	-	114	-	114
Debt	129,000	-	-	129,000
Other financial liabilities – RPP	-	181,927	(181,927)[6]	-
Contract deposits	-	16,978	-	16,978
Accrued pension liability	36,943	-	-	36,943
Accrued OPEB liability	79,914	-	6,567[7]	86,481
TOTAL LIABILITIES	**272,083**	**678,908**	**(574,169)**	**376,822**
NET DEBT	**(208,405)**	**(611)**	**(6,567)**	**(215,583)**
NON-FINANCIAL ASSETS				
Net tangible capital assets	95,051	4,498	-	99,549
Prepaid expenses	5,468	702	-	6,170
TOTAL NON-FINANCIAL ASSETS	**100,519**	**5,200**	**-**	**105,719**
ACCUMULATED DEFICIT				
Accumulated deficit from operations	(114,248)	91	(2,069)	(116,226)
Accumulated remeasurement losses	6,362	-	-	6,362
Invested in capital assets	-	4,498	(4,498)[8]	-
ACCUMULATED DEFICIT	**(107,886)**	**4,589**	**(6,567)**	**(109,864)**

[4] Market receivables as of December 31, 2014
[5] Market payables as of December 31, 2014
[6] RPP payables as of December 31, 2014
[7] Increase in OPEB liability as of January 1, 2015
[8] Move to accumulated deficit from operations

Independent Electricity System Operator
Statement of Operations and Accumulated Deficit (unaudited)
Restated for the year ended December 31 (in thousands of Canadian dollars)

	2014 Budget	2014 Actual	2013 Actual
WHOLESALE MARKET OPERATIONS			
System fees	186,916	189,754	191,617
Other revenue	3,291	6,254	4,863
Interest and investment income	1,012	2,816	2,395
Wholesale market operations revenue	**191,219**	**198,824**	**198,875**
Compensation and benefits	110,400	116,727	109,709
Professional and consulting	25,744	20,035	19,762
Operating and administration	30,557	31,374	31,053
Wholesale market operating expenses	**166,701**	**168,136**	**160,524**
Amortization	20,051	16,582	17,172
Net interest	1,189	1,375	912
Wholesale market expenses	**187,941**	**186,093**	**178,608**
IESO-OPA amalgamation expenses	-	10,883	-
Wholesale market operations annual surplus	**3,278**	**1,848**	**20,267**
MARKET SANCTIONS AND PAYMENT ADJUSTMENTS			
Market sanctions and payment adjustments	**-**	**2,687**	**3,191**
Compensation and benefits	2,568	2,592	2,591
Professional and consulting	1,515	1,677	1,244
Operating and administration	-	94	21
Customer education and market enforcement expenses	**4,083**	**4,363**	**3,856**
Market sanctions and payment adjustments annual deficit	**(4,083)**	**(1,676)**	**(665)**
SMART METERING ENTITY			
Smart metering charge	**45,207**	**45,735**	**30,144**
Compensation and benefits	3,378	2,909	2,634
Professional and consulting	22,530	16,169	17,650
Operating and administration	1,683	2,931	850
Smart metering operating expenses	**27,591**	**22,009**	**21,134**
Amortization	3,905	4,543	3,836
Net interest	1,831	1,317	1,561
Smart metering expenses	**33,327**	**27,869**	**26,531**
Smart metering entity annual surplus	**11,880**	**17,866**	**3,613**
ANNUAL SURPLUS	**11,075**	**18,038**	**23,215**
ACC. DEFICIT FROM OPERATIONS, BEGINNING OF PERIOD	(127,697)	(127,697)	(122,126)
ACC. DEFICIT FROM OPERATIONS, END OF PERIOD	**(116,622)**	**(109,659)**	**(98,911)**