Independent Electricity System Operator ("IESO" or the "Company") is considering making changes in its accounting policies to reflect the balances of market participants within the IESO-administered markets (see separate technical analysis) and the economic impacts of rate regulation, as the Company believes that the changes would result in a more appropriate presentation of events or transactions in its financial statements.

Issue being considered in this document is: Can the IESO adopt the guidance in ASC 980 *Regulated Operations (US GAAP in FASB)*?

Background and Assumptions The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The IESO's legal status is a not-for-profit, non-taxable, corporation established pursuant to Part II of the *Electricity Act, 1998*. IESO is classified as an Other Governmental Organization and prepares its financial statements in accordance with Canadian public sector accounting standards (PSAB).
2. IESO is rate regulated by the OEB in accordance with the *Electricity Act, 1998* and the *Ontario Energy Board ("OEB") Act, 1998* but currently does not recognize the economic impacts of rate regulation in its general purpose financial statements.

   To confirm with IESO and their auditors (KPMG):

   - **IESO operations are not rate regulated by the OEB. The OEB's function in IESO's operations is to approve a rate to meet IESO's projected revenue requirement to recover its operational costs incurred in association with their responsibility to maintain the reliability of the IESO-controlled grid and to provide settlement services for balances due/from generators, transmitters, and market participants**
   - **Except for the creation/management of a Smart Meter database, the OEB through its approval does not restrict the amount that IESO can recover from market participants for maintaining the reliability of the IESO-controlled grid and providing settlement services for balances due/from generators, transmitters, and market participants nor does the OEB approve the deferral of the recovery of these expenses**
   - **The OEB has issued one rate regulating order to the IESO regarding Smart Meter Charges which is effective from May 1, 2013 to Oct. 31, 2018.**

3. The IESO is required to obtain approval from the OEB under s. 25(1) of the Electricity Act 1998 for the approval of its own expenditures, revenue requirements and fees. The last rate approval was obtained on December 31, 2016.

   To confirm with IESO and their auditors (KPMG):

   - **IESO operations are not rate regulated by the OEB. The OEB's function in IESO's operations is to approve a rate to meet IESO's projected revenue requirement to recover its operational costs incurred in association with their responsibility to maintain the reliability of the IESO-controlled grid and to provide settlement services for balances due/from generators, transmitters, and market participants**
   - **Except for the creation/management of a Smart Meter database, the OEB through its approval of IESO's revenue requirement does not restrict the amount that IESO can recover from market participants for all reasonable costs of maintaining the reliability of the IESO-controlled grid and providing settlement services for balances due/from generators, transmitters, and market participants nor does the OEB approve the deferral of the recovery of these expenses**

4. The OEB issued a Decision and Order on March 28, 2013 that permits IESO to recover the MDMR costs (the Smart Metering Charge) (see Appendix B). *(i.e. Costs incurred in the past will be fully recovered through future rates)*

    - **The OEB has issued only this one rate regulating Decision and Order to the IESO. This Order relates to IESO's Smart Meter Charges and is effective from May 1, 2013 to Oct. 31, 2018.**

5. Furthermore, in accordance with the *Electricity Act, 1998* and the *OEB Act, 1998*, the IESO has approved variance accounts to record all amounts payable or receivable by it in connection with the amounts paid to generators, the Financial Corporation, distributors and to entities with whom the IESO has a procurement contract. (i.e. costs incurred in the past will be fully recovered through future rates).

    To confirm with IESO and their auditors (KPMG):

    - **The variance accounts outlined in #5 above are referred to as "Market Accounts" in IESO's December 31, 2016 financial statements**
    - **The Market Accounts track the point in time balances of due to/due from generators, transmitters and market participants for market transactions**
    - **The Market Accounts are not rate regulated balances for the IESO,**
    - **Similar to the other assets and liabilities balances that used to be recorded in the financial statements of the former Ontario Power Authority financial statements, some balances (variance accounts) within the Market Accounts track the effects of rate regulation on the operations of the generators (i.e. OPG) but these balances are not rate regulated assets and liabilities from IESO's point of view.**

6. The IESO would change its accounting policies to permit the recognition of the economic impacts of rate regulation as from the 2016 financial year. IESO would adopt the guidance of ASC 980 *Regulated Operations* to better reflect the economic substance of its operations and enhance the transparency and accountability of its financial reporting.

    To confirm with IESO management:

    - **The OEB has issued one rate regulating order/decision that affects IESO's operations. This rate order was issued on March 28, 2013 regarding the development and management of a Smart Meter database that is in effect from May 1, 2013 to October 31, 2018.**
    - **None of the IESO's other operations are subject to rate regulation by the OEB**
    - **In addition, due to IESO's transition to reporting to Public Sector Accounting Standards (PSAS) in 2010 and difference in pension accounting under PSAS and IESO's former accounting standards, a rate regulated balance was created to reflect the difference in pension liability under the two different accounting standards. The recognition of this balance on an annual basis will lead to an approximately $4 million reduction on IESO's system fees.**
    - **Management and the Board decided that adopting rate regulated accounting for the last three fiscal years of the seven-year recovery period for the Smart Metering database and the $4 million annual charge for pension accounting differences better reflects the economic substance of IESO's operations and enhances the transparency and accountability of IESO's financial reporting.**