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Yours very truly,

KPMG LLP

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Memo to file to address the issues raised by the AG, dated July 25, 2017

This memorandum addresses the issues raised by the Office of the Auditor General in its email sent to John Gordon on June 20, 2017. We have summarized the issues raised into 17 issues, each individually discussed in more detail in the balance of this memorandum. The comments set out herein are specific to the accounting by IESO and do not relate to the accounting by another entity, including the Province of Ontario.

Summary of the conclusions reached in this memorandum

The IESO changed its accounting policies to permit the recognition of the economic effects of rate regulation as from the 2016 financial year. IESO adopted the guidance of ASC 980 *Regulated Operations* ("ASC 980") to better reflect the economic substance of its operations and enhance the relevance, transparency and accountability of its financial reporting.

As further discussed in this memo, we believe that a rate-regulated entity reporting under PSAS is allowed to use the GAAP hierarchy under Public Sector Accounting Standards ("PSAS") to adopt ASC 980. We note that rate-regulated entities that were reporting under Part V of the CPA Handbook before they transitioned to IFRS recognized the economic effects of rate regulation using the GAAP hierarchy in Part V of the CPA Handbook, which is substantially consistent with the GAAP hierarchy in PSAS. These rate-regulated entities and their auditors concluded that the concepts in the other GAAP source (i.e. ASC 980) are compatible with the qualitative characteristics of financial information, the elements of financial statements (including the definitions of assets and liabilities), and the recognition and measurement criteria in Section 1000 of Part V of the CPA Handbook.

Based on the analyses performed in this memorandum, we concur with the following conclusions by management of the IESO:

- The IESO believes 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 (see IESO's 2016 financial statements, note 3; issue 3, page 5);
- PSAS neither explicitly permits, nor prohibits, the recognition, measurement, presentation or disclosure of rate-regulated activities (see issue 1, page 2);
- The IESO is similar to the other eight ISO entities across North America and the recognition of the market accounts and the economic effects of rate regulation improved the comparability of the IESO with its peers (see issue 2, page 4);
- The GAAP hierarchy was properly applied by the IESO (see issue 3, page 5);
- The GAAP hierarchy under PSAS does not prohibit the use of US GAAP, especially when US GAAP is the only accounting framework in North America that provides detailed guidance on rate-regulated operations (see issue 4, page 10);
- The IESO did not in its 2016 financial statements apply an exemption to recognize the economic effects of rate regulation, but used the GAAP hierarchy to do so (see issue 5, page 10);
- When the exemption from applying the GAAP hierarchy contained in Section 1100 of Part V of the CPA Handbook by rate-regulated entities was removed in 2009, rate-regulated entities continued to recognize the economic effects of rate regulation under Part V using the GAAP hierarchy in Section 1000 (see issue 5, page 12);
- The adoption of regulatory accounting under Part V of the CPA Handbook was not based on industry practice but was permitted through the application of the GAAP hierarchy (see issue 5, page 12);
- ASC 980 is not an exemption from, but an application of, US GAAP (see issue 6, page 13);
- Regulatory assets meet the definition of an asset under US GAAP, Part V of the CPA Handbook and PSAS (see issue 7, page 15);
- The IESO is a rate-regulated entity by the OEB and has a number of variance accounts approved by the OEB that meet the criteria for recognition under ASC 980 (see issue 8, page 19);
- IESO does not have to give precedence to IFRS over other accounting frameworks. It is appropriate for the IESO to reference the private sector guidance when applying the GAAP hierarchy as PSAS does not provide detailed guidance on rate-regulated accounting (see issue 9, page 20);
- The financial statements for the market accounts have included regulatory assets and liabilities for a number of years (see issue 10, page 21);
- IESO is a self-sustaining entity as it does not receive transfers or subsidies from the government and all its costs are recovered from customers through the market participants (see issue 11, page 22);

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- Regulatory assets are neither considered intangible assets nor deferred costs (see issues 12, 14, pages 23, 25);
- The OEB meets the criteria of independent, third-party regulator (see issue 13, page 24);
- The transactions related to the market accounts should be recorded in the TESO's books as they meet the criteria in paragraphs 9 and 11 of PS 3450 *Financial Instruments*. The assets and liabilities should be recorded on a gross basis and revenue and expenses should be recorded on a net basis (see issue 15, page 27);
- The Ontario Fair Hydro Plan, Act 2017 is not considered to be a price controls regime as defined by ASC 980 (see issue 16, page 29); and
- Rate-regulated entities reporting under PSAS, which receive substantial subsidies from their governments, do not meet the scope criteria in ASC 980-10-15-2 (b) as their rates are not designed to recover the specific entity's costs of providing the regulated services or products (see issue 17, page 30).

1. Does PSAS provide explicit guidance on rate-regulated activities?

PSAS

No, PSAS neither explicitly permits, nor prohibits, the recognition, measurement, presentation or disclosure of rate-regulated activities. In the absence of specific guidance in PSAS, an entity is permitted under PSAS Section 1150 to apply the identified GAAP hierarchy in determining the appropriate accounting for the specified transactions. As analyzed below, the TESO believes that it met the criteria in PS 1150 when it adopted the recognition and measurement principles of ASC 980 for the economic effects of rate regulation.

Specifically, PS 1150.18 and 19 state:

"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." (Emphasis added)

Since the subject of rate regulation is not covered in the PSAS defined "primary sources of GAAP", in accordance with PSAS we have considered these additional sources.

We note that the sources listed in paragraph 19 are highlighted as examples of important sources to consult rather than being an exhaustive list of sources that should be considered by a public sector reporting entity when selecting an accounting policy. This view is supported by paragraph 18, which states that PS 1150.19-.24 "identify some of the other sources". The frameworks referenced in paragraph 19 include frameworks from other jurisdictions, including frameworks for profit oriented enterprises, as well as frameworks specifically developed for public sector entities, which indicates that PS 1150 does not restrict public sector entities from consulting frameworks that were primarily developed for entities other than public sector reporting entities as long as the criteria in PS 1150 are met.

In the absence of guidance in an accounting framework, preparers and auditors are required to apply judgment in the development of accounting policies. Until AcSB, GASB and IASB issued their guidance on rate regulation, utilities and their auditors were solely required to apply judgment. Currently, FASB requires, and IASB (through IFRS 14), ASPE and GASB permit, the recognition of the economic effects of rate regulation when an entity meets defined criteria. PSAS is silent on the application of rate regulation and, as a result, utilities and their auditors are required to apply professional judgment in considering other aspects of the GAAP hierarchy.

AcSB

Within AcSB, Part I - IFRS and Part II - Accounting Standards for Private Enterprises (ASPE) provide limited guidance on the accounting for the economic effects of rate regulation as discussed further below.

– IFRS

IASB has not completed its current project on rate-regulated activities and current standards only include an interim standard (i.e. IFRS 14 *Regulatory Deferred Accounts*) that allows an entity within its scope to continue to account for rate-regulated activities in a manner consistent with its pre-IFRS accounting framework. The pre-IFRS accounting framework for those Canadian rate-regulated entities that have adopted

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IFRS 14 is the legacy Canadian GAAP included in Part V of the CPA Handbook. As Part V did not include a separate section on the recognition and measurement of regulatory assets and liabilities, entities reporting under Part V have utilized the GAAP hierarchy in accordance with Sections 1100.04, .24 and 32B to adopt ASC 980 guidance for rate-regulated activities.

– ASPE

ASPE defines a rate-regulated entity, provides guidance on certain aspects of the disclosure and presentation of information in the financial statements of rate-regulated entities through AcG 19 *Disclosures by entities subject to rate regulation*, and provides specific guidance under four Sections (3061 *PPE*, 3465 *Income Taxes*, 3475 *Disposal of long-lived assets and discontinued operations* and 3850 *Interest capitalized*). While ASPE provides no specific guidance on the recognition of regulatory assets and liabilities, it clearly allows such accounting for entities that are subject to rate regulation. For example, AcG 19 par. 7 requires disclosure of assets and liabilities recognized solely as a result of the effects of rate regulation which would not be a possible disclosure if such effects could not be recorded in the entity's financial statements.

Rate-regulated entities reporting under ASPE have used the GAAP hierarchy to adopt the recognition and measurement guidance for regulatory assets and liabilities of ASC 980.

FASAB

The “*FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended*” (“*FASAB Handbook*”) contains the body of accounting concepts and standards for the U.S. Federal Government. FASAB does not provide accounting guidance for entities with rate-regulated activities. However, we understand from our communication with FASAB that the FASAB GAAP hierarchy of accounting standards allows federal entities to apply FASB standards for matters not addressed in FASAB standards.

As an example, the U.S. Department of Energy (“DOE”) reports under the Statement of Federal Financial Accounting Standards (SFFAS, which is an aspect of FASAB) and recognizes regulatory assets in its financial statements¹. Extracts from the note 1.A Basis of presentation and note 5 Regulatory Assets are as follows:

Note 1.A: These consolidated and combined financial statements have been prepared to report the financial position and results of operations of the United States (U.S.) Department of Energy (the Department or DOE). The statements were prepared from the books and records of the Department in accordance with generally accepted accounting principles applicable to federal entities.

Note 6: “The Department’s PMAs record certain amounts as assets in accordance with the Financial Accounting Standards Board’s Accounting Standards Codification (FASB ASC) 980, Regulated Operations. The provisions of this standard require that regulated enterprises reflect rate actions of the regulator in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise. In order to defer incurred costs under this standard, a regulated entity must have the statutory authority to establish rates that recover all costs, and those rates must be charged to and collected from customers.” (Emphasis added)

We note the DOE’s regulatory assets include balances arising from a variety of transactions, including debt financings, repayments towards previous funding of generation assets, and provisions for costs incurred to be funded through future operations.

GASB

GASB 62 permits (i.e. provides a choice to) a governmental entity to recognize the economic effects of rate regulation in financial statements for periods beginning after December 15, 2011. Before the issuance of GASB 62, preparers and auditors were required to apply judgment as to whether a governmental entity could apply ASC 980 (previously called FAS 71). GASB 62 section “How the Changes in This Statement Will Improve Financial Reporting” states that:

“The requirements in this Statement will improve financial reporting by contributing to the GASB’s efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. This effort brings the authoritative accounting and financial reporting literature

¹ https://www.energy.gov/sites/prod/files/2016/11/B34/DOE_FY2016_AFR.pdf

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together in one place, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users. It will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments, thereby resulting in a more consistent application of applicable guidance in financial statements of state and local governments." (Emphasis added)

GASB 62 par. 149 states that "If some of a business-type activity's operations are regulated and meet the criteria of paragraph 476 and the entity elects to apply paragraphs 476-500, those provisions should be applied to only that portion of the business-type activity's operations." (Emphasis added)

IPSAS

IPSAS does not provide accounting guidance for entities with rate-regulated activities.

FASB

The recognition of the economic effects of rate regulation dates back to the early 1900s. FAS 71 required an entity to recognize the economic effects of rate regulation in financial statements for fiscal years beginning after December 15, 1983. Before the issuance of FAS 71, preparers and auditors were required to apply judgment with respect to the development of accounting policies to recognize the economic effects of rate regulation.

ASC 980 must be applied by entities that meet certain criteria. Section 10-15-2 of ASC 980 states that "The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria..."

2. How does IESO compare to other ISO entities in North America?

There are nine ISO entities in North America; seven in the U.S. and two in Canada (IESO and AESO). It is important to note that, similar to IESO, 7 of the 8 other ISO entities across North America are not-for-profit organizations (the 8th one is an LLC, non-stock company), 7 of the other 8 entities recognize the balances of the market participants and 6 of the other 8 entities recognize the economic effects of rate regulation (see Appendix D for a summary of these nine entities). All these entities state in the notes to their financial statements that their activities include the recovery of administrative fees for collecting amounts from the distributors of electricity and paying the contracts of the generators of electricity.

The two entities that do not recognize the economic effects of rate regulation are California ISO ("CAISO") and Southwest Power Pool ("SPP"). CAISO's accounting framework is GASB, which permits the recognition of regulatory assets and liabilities while SPP's accounting framework reporting is FASB, which requires the recognition of regulatory assets and liabilities that meet the criteria under ASC 980. Based on the communication between IESO and CAISO, we understand that the latter concluded that the need to recognize regulatory assets and liabilities (under FAS 71) was no longer necessary since it has other mechanisms in place to adjust its rates (under certain conditions) up or down, to ensure their revenue requirement for the year is met and, as a result, it does not have any variance accounts that would qualify as regulatory assets or liabilities under ASC 980. Based on the communication between IESO and SPP, we understand that the latter does not have any variance accounts that would qualify as regulatory assets or liabilities under ASC 980.

Although the IESO and 7 of the other 8 ISO entities are not-for-profit organizations, none have adopted the accounting for not-for-profit organizations as they do not meet its criteria. PSAS defines a government not-for-profit organization as a government organization that has all of the following characteristics:

- (a) It is a separate entity with the power to contract in its own name and that can sue and be sued.
- (b) It has counterparts outside the public sector as defined in paragraph .02.
- (c) It is an entity normally without transferable ownership interests.
- (d) It is an entity organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose.
- (e) Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

The IESO does not meet either criteria (d) or (e), as it provides services for the fees it receives which would be considered a financial return.

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3. Was the GAAP hierarchy appropriately applied?

In accordance with PS 2120.02, the IESO can adopt a new accounting policy, to reflect the economic effects of rate regulation, only if it is considered that the change of accounting policy would result in a more appropriate presentation of events or transactions in the financial statements of the government. PS 2120.02 states that

“a change in an accounting policy may be made... if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the government.”

As stated in the IESO's 2016 financial statements, the IESO believes 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.

PSAS does not explicitly address the accounting for transactions in a rate-regulated environment. Since PSAS is silent regarding the recognition of the economic effects of rate regulation, in accordance with PS 1150.05 IESO may consider other sources in the GAAP hierarchy to determine appropriate accounting policies for transactions in a rate-regulated environment. Using the GAAP hierarchy is a choice, not a requirement. As from 2016, the IESO chose to use the GAAP hierarchy to adopt the recognition and measurement principles of ASC 980. Said differently, the decision to adopt regulatory accounting in March 2017 for its 2016 financial statements is not prohibited as the choice was made by the IESO Board at that time based on its view that the financial statement presentation better reflects the economic effects of rate regulation. PS1150.05 states:

“When the primary sources of GAAP do not deal with the accounting and reporting in financial statements of transactions or events encountered by the public sector reporting entity, or additional guidance is needed to apply a primary source to specific circumstances, the selection of an appropriate accounting policy requires the exercise of professional judgment. In these circumstances, a public sector reporting entity should adopt accounting policies and disclosures that are consistent with: (Emphasis added)

(a) the primary sources of GAAP; and

(b) the application of the concepts described in FINANCIAL STATEMENT CONCEPTS, Section PS 1000.”

Based on PS 1150.05 above, the selection of an appropriate accounting policy requires the exercise of professional judgment and these policies have to be consistent with the primary sources of GAAP and the concepts in PS 1000.

Primary sources of GAAP

As mentioned above, PSAS does not explicitly address the accounting for transactions in a rate-regulated environment.

Although PS 3210 *Assets* applies for fiscal years beginning on or after April 1, 2017, we have considered and concluded that this new standard does not provide any guidance on the accounting for the economic effects of rate regulation.

If the concepts of the other source of GAAP (i.e. ASC 980) are in conflict with PSAS then PSAS prevails (PS 1150.12). For example, PSAS does not recognize intangible assets (PS 3150.03 and PS 1000.58). So if regulatory assets are considered to be intangible assets, they would not be allowed to be recognized through the other source of GAAP. As discussed in response to issue 12, management of the IESO and we concluded that ASC 980 is not in conflict with PS 3150.03 and PS1000.58 with respect to intangible assets.

Application of the concepts in PS 1000

As required by PS 1150.05 (b), we need to analyze whether the concepts in the other source (i.e. US GAAP and ASC 980) are compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in PS 1000. Based on the analysis below and in response to issue 7, we believe that these concepts under US GAAP are consistent and comparable to those under PSAS.

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(i) Qualitative Characteristics of Financial Information

FASB	PSAS 1000	Evaluation
Concepts and objectives are for both business and non-business organizations as well as governmental units (Concept #4.3 to 4.5)	This Section describes the concepts underlying the development and use of accounting principles in government financial statements (par. 01).	Similar as FASB also considers governmental units
Financial reporting should: <ul style="list-style-type: none"> – Be useful in making resource allocation decisions – Be useful in assessing services and ability to provide services – Be useful in assessing management stewardship and performance – Provide information about economic resources, obligations, net resources and changes in them (Concept # 4.33-.54) 	Financial statements should be relevant to the needs of the users and reliable. Relevance is achieved through timeliness, predictability and accountability value. Reliable information has the following characteristics: representational faithfulness, completeness, neutrality, conservatism and verifiability. (par. 28-29)	Similar

(ii) Elements of Financial Statements

FASB	PSAS	Evaluation
Assets		
Probable future economic benefits obtained or controlled by the entity as a result of past transactions or events. (Concept #6.25-.34)	Economic resources controlled by a government as a result of past transactions or event and from which future economic benefits are expected to be obtained. (par. 35)	Essential characteristics similar Regulatory assets meet the definition of asset as discussed in response to issue 7. FAS 71.75 states that the Board concluded that, for general-purpose financial reporting, the principal economic effect of the regulatory process is to provide assurance of the existence of an asset or evidence of the diminution or elimination of the recoverability of an asset.
Liabilities		
Probable future sacrifices of economic benefits arising from present obligations of the entity to transfer assets or provide services in the future as a result of past transactions or events. (Concept #6.35-.43)	Present obligations to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits with little or no discretion to avoid settlement. (par. 44)	Essential characteristics similar FAS 71.11 states that rate actions of a regulator can impose a liability on a regulated enterprise. Such liabilities are usually obligations to the enterprise's customers.
Revenues		
Inflows from delivering or producing goods, rendering services or other	Increases in economic resources resulting from operations,	Although PSAS is based on the change in the balance

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FASB	PSAS	Evaluation
activities that constitute the entity's central operations. (Concept #6.78-.79)	transactions and events of the accounting period. (par. 46)	sheet assets/liabilities model, the revenue recognized for regulatory assets would not be contradictory to this concept.
Expenses		
Outflows from delivering or producing goods, rendering services or carrying out other activities that constitute the entity's central operations. (Concept # 6.80-.81)	Decreases in economic resources resulting from operations, transactions and events of the accounting period. (par. 49)	Essential characteristics similar

(iii) Recognition Criteria

FASB	PSAS	Evaluation
To be recognized, an item must meet the definition of an element of the financial statements, must be measurable with sufficient reliability, be relevant and be reliable. (Concept # 5.64)	<p>To be recognized, an item must have an appropriate basis of measurement, a reasonable estimate can be made of the amount and if the item involves obtaining or giving up future economic benefits, it is expected those benefits will be obtained or given up. (par. 55)</p> <p>In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements. (par. 58)</p>	<p>Essential characteristics similar</p> <p>Regulatory assets have an appropriate basis of measurement (i.e. historical cost).</p> <p>A reasonable estimate can be made of the regulatory assets as they represent the difference between the amount paid to a supplier for goods or services received and the amount collected from the customers through the market participants.</p> <p>As the regulatory assets are approved by the OEB for future recovery in rates, the IESO is the only party that will realize the economic benefits (i.e. the receipts of cash).</p> <p>As discussed in response to issue 12, regulatory assets are not considered intangible assets. Intangible assets are non-financial assets. Regulatory assets are financial assets as defined in PS 1000 as they will be used to discharge existing liabilities to the generators of electricity.</p> <p>FAS 71.75. The Board concluded that, for general-purpose financial reporting, the principal economic effect of the regulatory process is to provide assurance of the</p>

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FASB	PSAS	Evaluation
		existence of an asset or evidence of the diminution or elimination of the recoverability of an asset. The regulator's rate actions affect the regulated enterprise's probable future benefits or lack thereof. Thus, an enterprise should capitalize a cost if it is probable that future revenue approximately equal to the cost will result through the rate-making process.

(iii) Measurement Criteria

FASB	PSAS	Evaluation
Measurement basis dependent upon nature of item. Historical cost basis, replacement cost, market value. (Concept # 5.65-.70)	Primarily using historical cost basis. Replacement cost and realizable value are also used, but in limited circumstances. (par. 60)	Essential characteristics similar Regulatory assets are measured at historical cost.

Evaluation whether regulatory assets under ASC 980 meet the definition of Assets as per Section PS 3210

Management of the IESO and we concluded that ASC 980 is not an exemption from the application of US GAAP (see discussion in response to issue 6) and regulatory assets under ASC 980 meet the definition of assets under PS 3210 (see discussion in response to issue 7).

Other sources of GAAP

Since the concepts in US GAAP and ASC 980 are consistent with PS 1000, IESO needs to determine the other sources of GAAP that it can use in reference to the criteria in PS 1150. It should be noted that US GAAP is the only widely applied accounting framework that provides detailed guidance on rate-regulated accounting to be applied to general-purpose external financial statements.

Criteria of PS 1150.08

Application of PS 1150.08 is required, in the absence of a source in Canada that specifically provides guidance on the accounting for rate-regulated transactions, to ensure that the alternative source of GAAP is consistent with PS 1150.05.

"A public sector reporting entity consults sources other than primary sources of GAAP to assist in selecting accounting policies and disclosures only when these sources comply with paragraph PS 1150.05. The public sector reporting entity evaluates sources in selecting the appropriate accounting policies and disclosures based on all of the following criteria:

- (a) The specificity of the source — A source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize.*
- (b) The authority of the issuer or author — A source issued by an accounting standard setter in its own jurisdiction is likely to be more relevant than a source issued by others in the same jurisdiction.*
- (c) The continued relevance of the source — The passage of time may diminish the relevance of certain sources.*
- (d) The development process for the source — A source developed after extensive consultation and debate is likely to be more relevant than a source developed without such discipline."*

As discussed in response to Issue 1, Part I - IFRS and Part II - ASPE only provide limited guidance on the accounting for the economic effects of rate regulation. As stated there:

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- ASPE defines a rate-regulated entity, provides guidance on certain aspects of the disclosure and presentation of information in the financial statements of rate-regulated entities through AcG 19 *Disclosures by entities subject to rate regulation*, and provides specific guidance under four Sections (3061, 3465, 3475 and 3850). While ASPE does not provide specific guidance on the recognition of regulatory assets and liabilities, it clearly allows such accounting for entities that are subject to rate regulation. For example, AcG 19 par. 7 requires disclosure of assets and liabilities recognized solely as a result of the effects of rate regulation which would not be a possible disclosure if such effects could not be recorded in the entity's financial statements. Entities reporting under ASPE have used the GAAP hierarchy to adopt ASC 980.
- IASB has not completed their current project on rate-regulated activities and current standards only include an interim standard (i.e. IFRS 14) based upon what was done under previous GAAP. Entities reporting under IFRS, which meet the criteria in IFRS 14 have also previously adopted ASC 980.

Rate-regulated entities in North America reporting under US GAAP, GASB, FASAB, ASPE, IFRS (entities which have elected to use IFRS 14 upon transition to IFRS) and legacy Canadian GAAP before the Canadian entities transitioned to IFRS (or to other accounting frameworks) generally all recognize the economic effects of rate regulation in accordance with ASC 980.

As a result, based on PS 1150.08 (a) and (b), in the absence of a specific source in Canada that provides detailed guidance for the accounting for the economic effects of rate regulation, management of the IESO and we have concluded that ASC 980 is the main source that deals with the accounting for the economic effects of rate-regulated activities and is therefore a relevant source.

Criteria	Evaluation
Source deals with the specific circumstance	Yes, ASC 980 <i>Regulated Operations</i>
Source is issued by an accounting standard setter	Yes, FASB
Source continues to be relevant	Yes, still used by rate-regulated entities
Source uses a consultative process and deliberation when developing policies	Yes, comprehensive consultative process and deliberation

Accounting for the economic effects of rate regulation under ASC 980 by Canadian rate-regulated entities is a long-standing practice in Canada in a variety of different industries. Although it is clear that industry practice in and of itself is not a sufficient basis for developing accounting policies, we note that this industry practice has continued to be acknowledged and recognized by the AcSB, including by reference to the disclosure and other requirements addressing rate-regulated accounting in ASPE, the AcSB's deferral of the adoption of IFRS in Canada for entities with rate-regulated activities, and the AcSB's continued participation in the IASB's project on rate-regulated activities, including their involvement in drafting IFRS 14.

Based on the judgment exercised by its management, IESO and we believe that the recognition of the economic effects of rate regulation results in a fair presentation of the financial affairs of IESO in accordance with PSAS. Based on discussions with the IESO, we understand that most, if not all, users of IESO's financial statements (including the IESO's Board of Directors, Province of Ontario, OEB and interveners, OPCD, OPG, Hydro One, LDCs, and other ISO entities in North America), exercising professional judgment, believe that the recognition of the economic effects of rate regulation provides better information, is well understood and results in a fair presentation in accordance with GAAP. It further provides users of financial statements with relevant and understandable information that represents faithfully how the impact of rate regulations affect the entity's financial position, performance and future cash flows. As mentioned earlier, 6 of the 8 other ISO entities across North America recognize the economic effects of rate regulation as it is considered to best support the fair presentation, transparency and accountability of their financial reporting and the two that do not do so do not have eligible transactions for recognition under ASC 980. This ensures compliance with PSAS 1150.11 which states:

"In selecting appropriate accounting policies and disclosures, interpretations of a source do not constitute evidence that the criteria in paragraph PS 1150.05 have been met if it is likely that most parties, exercising professional judgment, would reject them as not resulting in a fair presentation in accordance with GAAP."

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4. Do the other sources of GAAP under PS 1150 prohibit the use of US GAAP?

No. PS 1150 identifies some of the other sources that an entity might consult. PS 1150.18 and .19 state:

18. "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." (Emphasis added)

19. "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." (Emphasis added)

In response to issue 1 we set out linkages to IFRS, ASPE and GASB and identified that FASAB and IPSASB do not explicitly provide any relevant guidance for the recognition and measurement of regulatory balances. In addition, while FASB is not specifically mentioned as an example of "important sources to consult", it is also not prohibited. FASB's guidance is also specifically mentioned in GASB and is the basis on which ASPE and IFRS 14 rate-regulated accounting has been applied. Therefore, through the PSAS GAAP hierarchy, a rate-regulated entity can firstly consult ASPE as a source of GAAP and subsequently through the ASPE GAAP hierarchy, consult US GAAP and use ASC 980 for guidance.

As mentioned earlier, US GAAP is the only widely applied accounting framework that provides detailed guidance on rate-regulated accounting to be applied to general-purpose external financial statements. As stated in PS 1150.08 (a) "a source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize." As a result, the IESO believes that ASC 980 is an important and acceptable source to consult on matters not covered by PSAS provided it complies with PS 1150.05.

5. Did Part V of the CPA Canada Handbook – Accounting (the "legacy Canadian GAAP" or "Part V") provide an exemption to use ASC 980?

It is important to note that the legacy Canadian GAAP under Part V is still relevant as Canadian rate-regulated entities reporting under IFRS 14 are required through IFRS 14.11 to continue to apply their previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory assets and liabilities, which were accounted for under Part V.

The GAAP hierarchy under PSAS, Section 1150 issued in 2005 was effective for fiscal years beginning on or after April 1, 2005, while the GAAP hierarchy under Part V of the CICA Handbook, Section 1100 issued in 2003 was effective for fiscal years beginning on or after April 1, 2005. As analyzed in Appendix F to this document, both GAAP hierarchies are consistent except for an exemption from applying Section 1100 granted to rate-regulated entities between 2003 and 2008 under Part V ("Original Section 1100"). After 2008, the exemption from applying Section 1100 was removed from the GAAP hierarchy under Part V ("Revised Section 1100").

Original Section 1100 under Part V was applicable for fiscal years beginning on or after October 1, 2003, except for rate-regulated entities. An exemption from applying Original Section 1100 was granted to those entities pending resolution of the AcSB project on rate-regulated operations.

- .32 "This Section applies to fiscal years beginning on or after October 1, 2003, except in the circumstances described in paragraph 1100.34. Earlier adoption is encouraged.
- .34 Pending completion of a separate project on rate-regulated operations, an entity is not required to apply this Section to the recognition and measurement of assets and liabilities arising from rate regulation. Entities are required to apply this Section to all other assets and liabilities for fiscal years beginning on or after October 1, 2003.
- .35 An entity that chooses not to apply this Section to the recognition and measurement of assets and liabilities arising from rate regulation is required to comply with all disclosure requirements of GAAP, and to disclose the nature of the differences between its accounting policies for assets and liabilities arising from rate regulation and those required by the primary sources of GAAP." (Emphasis added)

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As explained in the Basis for Conclusions of Original Section 1100 of Part V, the AcSB granted an exemption from the application of Section 1100 to the assets and liabilities arising from rate regulation in the GAAP hierarchy pending completion of a separate project on rate-regulated operations.

- .90 *"The AcSB considered whether to grant temporary relief from the application of Section 1100 to any type of entity. Given the AcSB's active project on rate-regulated operations, members were sympathetic to the fact that such an entity may make changes to adopt Section 1100 and then have to make further changes (perhaps reversing previous decisions) to adopt the future requirements of any CICA Handbook - Accounting amendments related to rate-regulated operations. However, the AcSB expressed concern with a blanket exclusion of rate-regulated operations from Section 1100. The AcSB noted that the specific issues that rate-regulated operations face in applying Section 1100 appear to apply only to those assets and liabilities that are affected by rate regulation. The AcSB did not see a need to provide an exemption from the requirements of Section 1100 for any other aspect of accounting by a rate-regulated operation. Furthermore, the AcSB did not have sufficient information to develop a robust definition of a "rate-regulated operation". Many entities undertake both rate-regulated activities, and other activities that are unaffected by rate regulation. The AcSB did not see validity in exempting those activities unaffected by rate regulation.*
- .91 *Accordingly, the AcSB granted temporary relief from the application of Section 1100 only to the recognition and measurement of assets and liabilities arising from rate regulation, pending completion of a separate project on rate-regulated operations. Entities are required to apply Section 1100 to all other assets and liabilities for fiscal years beginning on or after October 1, 2003. Entities that choose not to apply Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation must nonetheless comply with all disclosure requirements of GAAP, and disclose the nature, but not necessarily the effect, of the differences between its accounting policies for assets and liabilities arising from rate regulation and those required by the primary sources of GAAP."* (Emphasis added)

As the AcSB's project for rate-regulated operations was stopped in 2007, the AcSB amended Section 1100 to remove the temporary exemption granted to rate-regulated entities. Handbook revision release no. 47, dated December 2007, stated:

"Deleted paragraphs 1100.34- 35 to remove the temporary exemption from the requirement to apply this Section to the recognition and measurement of assets and liabilities arising from rate regulation, and a disclosure requirement relating to this exemption."

"Added paragraph .32B to specify the effective date of this Section as it pertains to the recognition and measurement of assets and liabilities arising from rate regulation." (Emphasis added)

As a result of the 2007 amendment, rate-regulated entities were required to apply Revised Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation. Paragraph 32B was added to Section 1100 as follows:

"32B This Section applies to the recognition and measurement of assets and liabilities arising from rate regulation in interim and annual financial statements relating to fiscal years beginning on or after January 1, 2009. Rate regulation exists when all of the following criteria are present:

- (a) The rates for regulated services or products provided to customers are established by or are subject to approval by a regulator or a governing body empowered by statute or contract to establish rates to be charged for services or products.*
- (b) The regulated rates are designed to recover the cost of providing the services or products.*
- (c) It is reasonable to assume that rates set at levels that will recover the cost can be charged to and collected from customers in view of the demand for the services or products and the level of direct and indirect competition."*

Commencing in 2009, rate-regulated entities reporting under Part V used Section 1100 and concluded that while the primary source of GAAP did not provide specific guidance on the recognition and measurement of regulatory assets and liabilities, impacted entities were able to apply the GAAP hierarchy to reach a conclusion that ASC 980 (then FAS 71) was in accordance with Canadian GAAP.

It is useful to analyze how other sources of GAAP under Section 1100 of the legacy Canadian GAAP have been applied in 2009 by Canadian entities with rate-regulated activities, as the temporary exemption for the measurement and recognition of assets and liabilities arising from rate-regulated activities was removed from Section 1100.

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- .03 *"An entity should apply every primary source of GAAP that deals with the accounting and reporting in financial statements of transactions or events encountered by the entity."*
- .04 *When the primary sources of GAAP do not deal with the accounting and reporting in financial statements of transactions or events encountered by the entity, or additional guidance is needed to apply a primary source to specific circumstances, an entity should adopt accounting policies and disclosures that are:*
- (a) consistent with the primary sources of GAAP; and*
 - (b) developed through the exercise of professional judgment and the application of the concepts described in FINANCIAL STATEMENT CONCEPTS, Section 1000."*

As examples, we have provided below extracts from the consolidated financial statements of Ontario Power Generation, Toronto Hydro Corporation and Fortis Inc. for the year ended December 31, 2009 on the accounting policies adopted for the recognition and measurement of assets and liabilities arising from rate regulation under the legacy Canadian GAAP. OPG and Fortis are audited by EY and Toronto Hydro by KPMG.

Ontario Power Generation

"The CICA revised its guidance on accounting for rate-regulated operations, effective January 1, 2009, with amendments to Handbook Section 1100, Generally Accepted Accounting Principles, ("Section 1100"), Handbook Section 3465, Income Taxes, ("Section 3465"), and Accounting Guideline 19, Disclosures by Entities Subject to Rate Regulation, ("AcG-19") as follows:

- To remove the temporary exemption pertaining to the application of Section 1100 to rate-regulated operations, including the elimination of the opportunity to use industry practice as an acceptable basis for recognition and measurement of assets and liabilities arising from rate regulation"*

"In addition, effective January 1, 2009, with the removal of the temporary exemption in Section 1100, the Company must now apply Section 1100 to the recognition of assets and liabilities arising from rate regulation. Certain assets and liabilities arising from rate regulation continue to have specific guidance under a primary source of Canadian GAAP that applies only to the particular circumstances described therein, including those arising under Handbook Section 1600, Consolidated Financial Statements, Handbook Section 3061, Property, Plant and Equipment, Section 3465, and Handbook Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. Other assets and liabilities arising from rate regulation do not have specific guidance under a primary source of Canadian GAAP. Therefore, Section 1100 directs the Company to adopt accounting policies that are developed through the exercise of professional judgment and the application of concepts described in Handbook Section 1000, Financial Statement Concepts. In developing these accounting policies, the Company may consult other sources including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. Therefore, in accordance with Section 1100, the Company has determined that these assets and liabilities qualify for recognition under Canadian GAAP and this recognition is consistent with the Financial Accounting Standards Board Accounting Standards Codification Topic 980, Accounting for the Effects of Certain Types of Regulation (formerly Financial Accounting Standards No. 71). As a result, there is no effect on the Company's financial statements for the year ended December 31, 2009, with the exception of the impact of the amendment to Section 3465, as discussed above." (Emphasis added)

Toronto Hydro Corporation

"Following the removal of the temporary exemption for rate-regulated operations included in Handbook Section 1100, the Corporation developed accounting policies for its assets and liabilities arising from rate regulation using professional judgment and other sources issued by bodies authorized to issue accounting standards in other jurisdictions. Upon final assessment and in accordance with Handbook Section 1100, the Corporation has determined that its assets and liabilities arising from rate-regulated activities qualify for recognition under Canadian GAAP and this recognition is consistent with U.S. Financial Accounting Standards Board Accounting Standards Codification 980 – "Regulated Operations". Accordingly, the removal of the temporary exemption had no effect on the Corporation's results of operations as of December 31, 2009." (Emphasis added)

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Fortis Inc.

"Effective January 1, 2009, the Canadian Accounting Standards Board (the "AcSB") amended the Canadian Institute of Chartered Accountants ("CICA") Handbook: (i) Section 1100, Generally Accepted Accounting Principles, removing the temporary exemption providing relief to entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation; and (ii) Section 3465, Income Taxes, to require the recognition of future income tax liabilities and assets, as well as offsetting regulatory assets and liabilities, by entities subject to rate regulation.

Effective January 1, 2009, with the removal of the temporary exemption in Section 1100, the Corporation must now apply Section 1100 to the recognition of assets and liabilities arising from rate regulation. Certain assets and liabilities arising from rate regulation continue to have specific guidance under a primary source of Canadian GAAP that applies only to the particular circumstances described therein, including those arising under Section 3061, Property, Plant and Equipment, Section 3465, Income Taxes, and Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. The assets and liabilities arising from rate regulation, as described in Note 4, do not have specific guidance under a primary source of Canadian GAAP. Therefore, Section 1100 directs the Corporation to adopt accounting policies that are developed through the exercise of professional judgment and the application of concepts described in Section 1000, Financial Statement Concepts. In developing these accounting policies, the Corporation may consult other sources, including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. Therefore, in accordance with Section 1100, the Corporation has determined that all of its regulatory assets and liabilities qualify for recognition under Canadian GAAP, and this recognition is consistent with the U.S. Financial Accounting Standards Board's Accounting Standard Codification 980, Regulated Operations. Therefore, there was no effect on the Corporation's consolidated financial statements as at January 1, 2009 as a result of the removal of the temporary exemption from Section 1100." (Emphasis added)

Since the application of the GAAP hierarchy (see discussion at issue 3), the financial statement concepts (see discussion at issue 3), and the definitions of assets and liabilities (see discussion at issue 7) under Part V and PSAS are similar, and since all rate-regulated entities in Canada have used the GAAP hierarchy under Part V to adopt ASC 980, we believe that IESO can adopt ASC 980 on the basis that it meets the criteria in ASC 980.

6. Is ASC 980 an exemption from the application of US GAAP?

ASC 980 is not an exemption from US GAAP, it is part of US GAAP. There is no mention in ASC 980 that states that it is an exemption. This issue was addressed in the Basis for Conclusions of FAS 71:

51. *"The FASB Discussion Memorandum, Effect of Rate Regulation on Accounting for Regulated Enterprises, issued in 1982 presented a threshold issue: "Should accounting prescribed by regulatory authorities be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises*
54. *The Board concluded that regulatory-prescribed accounting should not be considered generally accepted per se, but rather that the Board should specify how generally accepted accounting principles apply in the regulatory environment.*
55. *This Statement merely specifies how the effects of different types of rate actions are reported in general-purpose financial statements."*

Note that references to "regulatory prescribed accounting" are references to the accounting in regulatory required reports (e.g., rate applications) not in general purpose financial statements.

ASC 980-10-05-7 allows the recognition of assets in accordance with an order of regulatory authorities provided that the capitalization is appropriate under this section.

"Accounting requirements that are not directly related to the economic effects of rate actions may be imposed on regulated businesses by orders of regulatory authorities and occasionally by court decisions or statutes. This does not necessarily mean that those accounting requirements conform with generally accepted accounting principles (GAAP). For example, a regulatory authority may order an entity to capitalize and amortize a cost that would be charged to income currently by an unregulated entity. Unless capitalization of that cost is appropriate under this Topic, GAAP requires the regulated entity to charge the cost to current income." (Emphasis added)

ASC 980-10-05-7 indicates that only the economic effects of rate regulations that meet the recognition criteria under ASC 980 conform with GAAP. As stated in ASC 980-10-15-1, ASC 980 only provides incremental industry-specific guidance for the entities defined in this Scope Section.

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"10-15-1 The Subtopics within the Regulated Operations Topic only provide incremental industry-specific guidance for the entities defined in this Scope Section, or as further defined in the Scope Sections of the individual Regulated Operations Subtopics. Entities within the scope of this Topic shall also comply with the applicable guidance not included in this Topic."

Although the Basis for Conclusions of FAS 71 have not been included to ASC 980², they provide useful information for the understanding of the Standard. The Basis for Conclusions of FAS 71, in the Section regarding *Relationship of Regulatory-Prescribed Accounting to Generally Accepted Accounting Principles*, paragraphs 51- 55 specified how the effects of different types of rate actions are reported in general-purpose financial statements.

51. *"The FASB Discussion Memorandum, Effect of Rate Regulation on Accounting for Regulated Enterprises, presented a threshold issue: "Should accounting prescribed by regulatory authorities be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises?"*

52. *Virtually all respondents to the Discussion Memorandum indicated that accounting prescribed by regulatory authorities should not be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises. Respondents noted that the function of accounting is to report economic conditions and events. Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the generally accepted accounting principles applicable to business enterprises in general. The mere issuance of an accounting order not tied to rate treatment does not change an enterprise's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of generally accepted accounting principles.*

53. *Respondents also noted that regulatory-prescribed accounting has not been considered generally accepted per se in the past.*

54. *The Board concluded that regulatory-prescribed accounting should not be considered generally accepted per se, but rather that the Board should specify how generally accepted accounting principles apply in the regulatory environment.*

55. *Some respondents to the FASB Exposure Draft, Accounting for the Effects of Regulation of an Enterprise's Prices Based on Its Costs, suggested that the Board clarify the relationship of this Statement to an enterprise's regulatory accounting and to regulators' actions. This Statement does not address an enterprise's regulatory accounting. Regulators may require regulated enterprises to maintain their accounts in a form that permits the regulator to obtain the information needed for regulatory purposes. This Statement neither limits a regulator's actions nor endorses them. Regulators' actions are based on many considerations. Accounting addresses the effects of those actions. This Statement merely specifies how the effects of different types of rate actions are reported in general-purpose financial statements."* (Emphasis added)

This issue was addressed during a rate application of OPG (see rate application number OFB-2013-0321, Filed: 2014-03-19, Exhibit I., Tab 1.3, Schedule 1 Staff-006, Page 1 of 2
http://www.ols.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/430200/view/OPG_IRR_Issue%201_0_20140326.PDF

Question raised through interrogatory:

"Under ASC 980, please confirm OPG's understanding that the rate regulator has the authority to set and approve regulatory accounting policies which must then be included in the financial statements of the rate-regulated entity. If not, please explain."

Answer provided by OPG:

"OPG confirms that the OEB has the authority to set and approve regulatory accounting policies for the purposes of setting payment amounts and reporting to the OEB. However, the OEB does not have authority to set financial accounting requirements, as noted in the EB-2008-0408 Report of the Board (page 4), nor does ASC 980 mandate the inclusion of regulatory accounting policies in the financial statements of a rate-regulated entity."

² In the FASB's codification project Basis of Conclusions from issued standards were not carried forward into the ASC's.

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Effective January 1, 2012, OPG is required to prepare its financial statements in accordance with US GAAP pursuant to Ontario Regulation 395/11 under the Financial Administration Act (Ontario). Where applicable under US GAAP, OPG must therefore be in compliance with ASC 980. ASC 980 sets out specific requirements in accounting for the economic effects of rate regulation (i.e., economic benefits or obligations that are required to be obtained from, or settled with, the ratepayers as a result of regulation). ASC 980 does not require OPG to reflect the regulatory accounting policies prescribed by the regulator in its financial statements. In fact, reflecting such policies, other than as part of accounting for the economic effects of regulation in accordance with the specific guidance in ASC 980, would not be in compliance with ASC 980 and therefore US GAAP." (Emphasis added)

PS 1150.13 is very similar to ASC 980-10-05-7 as both prohibit the recognition of assets that do not conform with GAAP.

Similar to ASC 980-10-05-07, management of the IESO and we believe that PS1150.13 allows the recognition of assets in accordance with regulatory or legislative requirements provided these requirements are allowed by Section 1100, otherwise the financial statements cannot be described as being in accordance with GAAP.

PS1150.13: "A public sector reporting entity may be required to prepare financial statements in accordance with regulatory, legislative or contractual requirements. When these requirements are within the range of acceptable choices allowed by this Section, the basis of accounting can be described as being in accordance with GAAP. At times, conflict between GAAP and regulatory, legislative or contractual requirements may exist. In such cases, users of financial statements need to know that the statements are not prepared in accordance with GAAP. Therefore, if the basis of accounting used to prepare such financial statements conflicts with the requirements of this Section, that basis cannot be described as being in accordance with GAAP."

7. Do regulatory assets meet the definition of asset under US GAAP, Part V and PSAS?

PSAS

PS 1000.35 defines assets as "economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained." This definition is consistent with the definition of assets in paragraph 3 of the new standard PS 3210. The analysis performed below takes into account the additional guidance in PS 3210 on what is meant by an economic resource, control, future economic benefits and past events and transactions. The analysis of the three essential characteristics as defined by PS 3210.4 are analyzed in the next table.

Characteristics	Additional guidance	Comments
They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows. (par. 4(a))	<p>The essence of assets are their future economic benefits. Assets embody future economic benefits that allow public sector entities to achieve their objectives. The future economic benefits embodied in assets involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows or to reduce cash outflows. (par. 11)</p> <p>The future economic benefits embodied in an asset may also be in the form of generating future cash inflows. Cash inflows benefit the public sector entity because cash can be used to purchase or to provide goods and services, redistribute wealth or settle liabilities. (par. 13)</p>	<p>The economic benefit embodied in the variance accounts (i.e., regulatory asset) is the right to collect the incurred costs from the customers in order to settle the liability for the energy already consumed by the ratepayers.</p> <p>The electricity Act, 1998 ("EA") section 25.33(1) states:</p> <p><i>"The IESO shall, through its billing and settlement systems, make adjustments in accordance with the regulations that ensure that, over time, payments by classes of market participants in Ontario that are prescribed by regulation reflect,</i></p> <p><i>a) amounts paid to generators, the Financial Corporation and distributors, whether the amounts are determined under the market</i></p>

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		<p><i>rules or under section 78.1, 78.2 or 78.5 of the Ontario Energy Board Act, 1998; and</i></p> <p><i>b) amounts paid to entities with whom the IESO has a procurement contract, as determined under the procurement contract."</i></p>
<p>The public sector entity can control the economic resource and access to the future economic benefits. (par. 4(b))</p>	<p>Economic resources can arise from, but are not limited to, the following: government's own legislation (for example, taxes, fines and penalties); (par. 08(c))</p> <p>A public sector entity controls the economic resource and access to the future economic benefits when it:</p> <ul style="list-style-type: none"> a. can benefit from the economic resource through its capacity to provide goods and services, to provide future cash inflows or to reduce cash outflows; b. can deny or regulate access to those benefits by others; and c. is exposed to the risks associated with the economic resource. (par.16) 	<p>The economic resources is the right created by the legislation that the energy costs IESO incurs will result in future cash flows. In the regulatory environments, incurring costs creates an enforceable right to set rates at a level that permits IESO to recover those costs. The adjustment of future rates is the mechanism the OEB uses to implement the right.</p> <p>The IESO can control the asset or restrict others' access to it.</p> <p>Currently, the FA section 25.33(5) states:</p> <p><i>"The IESO shall establish and maintain such variance accounts as may be necessary to record all amounts payable or receivable by it under this section."</i></p>
<p>The transaction or event giving rise to the public sector entity's control has already occurred. (par.4(c))</p>	<p>It is the occurrence of a past transaction or event on or before the financial statement date that distinguishes a present economic resource controlled by a public sector entity from an economic resource that may be controlled by a public sector entity in the future. (par. 25)</p> <p>The past transaction or event that gives rise to control of an economic resource resulting from exchange agreements or contracts usually occurs at the point of exchange. This arises when substantially all the benefits and risks of ownership have been transferred to the public sector entity and normally coincides with the disbursement of funds, exchange of other assets or assumption of liabilities. (par. 26)</p>	<p>The past event giving rise to IESO's control occurs as the customer uses energy and becomes committed to pay.</p> <p>The IESO, through its OEB license, has the right to collect amounts from the customers for the energy consumed.</p> <p>FAS 71.75 states that the Board concluded that, for general-purpose financial reporting, the principal economic effect of the regulatory process is to provide assurance of the existence of an asset or evidence of the diminution or elimination of the recoverability of an asset. The regulator's rate actions affect the regulated enterprise's probable future benefits or lack thereof. Thus, an enterprise should capitalize a cost if it is probable that future revenue approximately equal to the cost will result through the rate-making process.</p>
<p>Conclusion: The right to collect regulatory assets meets the definition of assets.</p>		

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US GAAP

The Edison Electric Institute ("EEI")'s letter to the IASB dated November 23, 2011 related to the IASB Agenda Consultation 2011 (see Appendix I) provides analyses of whether regulatory assets and liabilities meet the definitions of asset and liability under US GAAP and whether FAS 71 is consistent with the FASB Conceptual Framework. EEI is the association of the US shareholder-owned electric companies representing 95% of the ultimate customers in the shareholder-owned segment of the industry. Extracts from the letter:

Page 13: "The deliberations resulting in SFAS 71 ultimately acknowledged that there is no "special accounting" for rate-regulated activities; there are only generally accepted accounting principles which must account for (among other things) the effects of regulation consistent with the US Financial Reporting Framework. In fact, regulated entities in the US were already accounting for the effects of rate regulation although to varying degrees and not necessarily consistently prior to the issuance of SFAS 71. SFAS 71 did not introduce new accounting for the effects of rate regulation; rather, it narrowed the scope and recognition of those related previous accounting practices in order to provide a consistent framework and refined recognition and measurement criteria consistent with the US Framework." (Emphasis added)

Pages 16 to 19 provide an analysis which supports that regulatory assets and liabilities meet the general definitions of assets and liabilities under the FASB Conceptual Framework.

"Implicit in the issuance of SFAS 71 (now codified within ASC 980), is consistency of that standard with the FASB Conceptual Framework. FASB Concept Statement No. 6 identifies the definitions of elements of financial statements, while Concept Statement No. 5 addresses the relevant recognition and measurement criteria under the FASB's Conceptual Framework. Both are summarized in the table below and further support that regulatory assets and liabilities meet the general definitions of assets and liabilities under the FASB Conceptual Framework."

Paragraphs 58 and 59 of the Basis for Conclusions of FAS 71 concluded that regulatory assets meet the criteria of Concepts Statement 3 of an asset.

58. *"The economic effect cited by most respondents is the ability of a regulatory action to create a future economic benefit—the essence of an asset. For example, consider a regulated enterprise that incurs costs to repair damage caused by a major storm. If the regulator approves recovery of the costs through rates over some future period or is expected to do so, the rate action of the regulator creates a new asset that offsets the reduction in the damaged asset. The enterprise has probable future economic benefits—the additional revenue that will result from including the cost in allowable costs for rate-making purposes. The future benefits are obtained or controlled by the enterprise as a result of a past event—incurring the cost that results in the rate order. Thus, the criteria of Concepts Statement 3 for an asset are met."*

59. *"Most respondents that opposed special accounting for the effects of regulation cited the need for comparability between regulated and unregulated enterprises. Paragraph 119 of FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information, indicates that "... the purpose of comparison is to detect and explain similarities and differences." The Board concluded that comparability would not be enhanced by accounting as though regulation had no effect. Regulation creates different circumstances that require different accounting."* (Emphasis added)

As discussed in response to issue 1, GASB and FASB also allow for the application of ASC 980 in financial statements prepared in accordance with their frameworks.

CGAAP (pre-IFRS)

As mentioned earlier, the exemption to not apply section 1100 under Part V by a rate-regulated entity was removed in 2009, and, as a result, those entities were allowed to utilize Section 1100, and particularly paragraph 32B, in their evaluation of the appropriate recognition and measurement of regulatory assets and liabilities. As mentioned earlier, the GAAP hierarchy under Part V was similar to the GAAP hierarchy under PSAS and, when looking to other sources of GAAP, both hierarchies required the other sources of GAAP (which included, or did not preclude, ASC 980) to be evaluated based on the following criteria³:

1. whether they are consistent with accounting policies and disclosure within PSAS (or Part V),
2. whether they are consistent with the application of concepts in Section 1000 of PSAS (or of Part V),

³ See particularly Part V, section 1100.03 and .07 and PSAS 1150.05 and .08.

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3. does the source meet all of the following criteria for the other source:
 - (a) deals with the specific circumstance
 - (b) is issued by an accounting standard setter
 - (c) continues to be relevant
 - (d) uses a consultative process and deliberation when developing policies

A rate-regulated entity reporting under Part V was required by Section 1000 *Financial statement concepts* to analyze whether the concepts in the other source of GAAP (i.e. ASC 980) were compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in Section 1000 of Part V. These requirements included the evaluation whether regulatory assets and liabilities under ASC 980 met the definitions of asset and liability under Section 1000 of part V.

It is important to note that the publication issued by the Office of the Auditor General of British Columbia *Summary of the Comparison of the Canadian PSAS with the CICA Handbook Part V* states that the framework under Part V is either similar to PSAS or silent in some aspects (see Appendix E).

After the removal of the exemption from Part V, all rate-regulated entities concluded that ASC 980 met all the requirements and continued to recognize regulatory assets and liabilities under Part V until they transitioned to IFRS or other accounting frameworks.

As a result, since rate-regulated entities reporting under Part V recognized the economic effects of rate regulation using the GAAP hierarchy and since PSAS has a consistent GAAP hierarchy and accounting framework, management of the BSO and we believe that a rate-regulated entity reporting under PSAS should also be allowed to adopt ASC 980.

IFRS

IFRS 14 is silent as to whether regulatory assets meet the definition of asset.

However, IFRS has similar a definition of assets as both PSAS and US GAAP, and recent developments at the IASB are proceeding in a direction that suggests support for our view that regulatory assets are consistent with the conceptual definition under PSAS.

In 2012, the IASB has restarted a project on rate-regulated activities. The preliminary discussions that took place over the past several months at the IASB meetings indicate that the IASB's tentative thinking is that regulatory assets and liabilities meet the definitions of an asset and liability in the new Conceptual Framework. This was a combination of years of work at the IASB on the new Conceptual Framework. For example, the IASB staff discussed Agenda Paper 9A (see Appendix 11) at the IASB meeting of June 21, 2017.

Paragraph 17 states *"During the May 2017 Board meeting (see below) we also considered the interaction between the definitions of assets and liabilities and the characteristics of defined rate regulation. We concluded that a combination of those characteristics suggested that the rights and obligations created by the rate-adjustment mechanism are assets and liabilities, as those terms are expected to be defined in the forthcoming revised Conceptual Framework for Financial Reporting."*

The IASB staff discussed Agenda Paper 9 (see Appendix 11) at the IASB meeting of May 16, 2017, which addressed the new definitions of asset and liability and the related guidance under the new IFRS Conceptual Framework.

Paragraph 16 states *"Respondents to the Discussion Paper Reporting the Financial Effects of Rate Regulation, published in September 2014 (the Rate regulation DP), and participants in subsequent outreach asked us to explain how the model links to [the forthcoming revisions to] the Conceptual Framework for Financial Reporting (the Conceptual Framework), particularly the definitions of assets and liabilities. We outline, in paragraphs 17-21, the main aspects of the definitions and supporting guidance that we consider most pertinent to understanding the basis for the model. We have used the proposals in the Exposure Draft Conceptual Framework for Financial Reporting (the Conceptual Framework ED), updated when applicable for the Board's tentative decisions in subsequent discussions."*

Paragraph 18 states *"The definitions of assets and liabilities in the Conceptual Framework focus on rights and obligations. The guidance supporting the definitions highlights the importance of commercial substance and the need for contractual terms to have a discernible effect on the economics of a contract. In particular, paragraph 4.55 of the Conceptual Framework ED indicates that terms that bind neither party have no*

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commercial substance and should be disregarded.”

Paragraph 17 (a) states *“The Conceptual Framework ED provides the following definitions: An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.”*

Paragraph 19 states: *“The guidance accompanying the proposed definition of an asset highlights that for an entity to have an asset, it must have a right that both has the potential to produce economic benefits for the entity beyond those available to all other parties and is controlled by the entity. An entity controls an economic resource if it has the right to deploy the economic resource in its activities and if, in addition, any economic benefits from that resource flow to the entity (either directly or indirectly) rather than to another party. Control in this context does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances.”*

While these papers are not authoritative, we believe it demonstrates that current thinking around this topic is evolving such that the lack of rate-regulated accounting by entities following IFRS around the world does not undermine our conclusion that regulatory assets are consistent with the conceptual definitions under PSAS.

8. Does the OEB regulate the IESO?

Yes. 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’s 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) Market accounts.

Although the IESO is rate-regulated by the OEB, in considering ASC 980-10-05-7, the economic effects of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP. Therefore, it is important to determine whether IESO has a basis to conclude that the OEB approved the future recovery of costs incurred in the past through rate setting policies. The following analysis demonstrates that IESO is a rate-regulated entity by the OEB.

We note that the Report of the Ontario Energy Board on the Pension and OPEB costs issued on May 18, 2017 states on page 9 that *“The OEB is of the view that the IESO is a rate-regulated entity...”* (see Appendix G). As further detailed in the following paragraphs and in appendices 1 to 3, the OEB has permitted the IESO to set-up variance accounts for costs incurred in the past that will be fully recovered through future rates.

IESO’s expenditure, revenue requirements and fees

The IESO is required to obtain approval from the OEB under s. 25(1) of the Electricity Act for the approval of its own expenditures, revenue requirement and fees.

Extracts from the Electricity Act noting the OEB’s review and approval process for the IESO’s expenditures, revenue requirement and fees can be found in Appendix A.1. Extracts from the 2016 Decisions and Orders issued by the OEB related to IESO’s expenditure, revenue requirements and fees for the financial year 2016 can also be found in Appendix A.2. For all prior years, the Decisions and Orders issued by the OEB can be found on the OEB website.

Smart metering activities

The OEB Act states that the Smart Metering Entity shall not charge for meeting its obligations under Part IV.2 of the Electricity Act except in accordance with an order of the Board, which is not bound by the terms of any contract.

The OEB issued a Decision and Order on March 28, 2013 that permits IESO to create a variance account to recover the MDMR costs (the Smart Metering Charge) (see Appendix B).

Market accounts

The OEB Act, Electricity Act and associated regulations outline that variance accounts can or will be established for the Ontario Electricity Support Program (“OESP”), Regulated Price Plan (“RPP”) and Rural and Remote electricity Rate Protection (“RRRP”). Variance accounts have been approved by the OEB to recover the RPP and RRRP costs that have been deferred. The OESP costs that have been deferred at the request of the OEB should be approved for recovery at the next rate application.

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Specifically (see Appendix C):

OLSP: the OLSP Reg, O. Reg 314/125 S 6, sets out that the IESO shall establish a variance account.

RPP: Section 25.33 (5) of the Electricity Act sets out that the IESO shall establish and maintain such variance accounts as may be necessary. Section 79.16 (3) of the OFB Act, which deals with the commodity price for electricity for low volume consumers, sets out that the Board shall take into account balances in variance accounts established under section 25.33 of the Electricity Act, 1998 and make adjustments with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct.

RRRP: The RRRP Reg, O. Reg 442/01 S 5(9), sets out that the IESO shall establish a variance account.

It should be noted that the financial statements of the market accounts have included variance accounts for a number of years before the market accounts were recognized in the IESO's financial statements. These variance accounts, which relate to the RRRP, RPP and OESP costs, met and continue to meet the recognition criteria in ASC 980.

9. The private sector is driven by the generation of profit. In our view, the organization should have been analogized to PSAS first and then to more current standards on the issue.

Because IESO is an OGO, it has a choice between following PSAS or IFRS. IESO has chosen PSAS as the accounting framework it will follow in preparing its financial statements. Since IFRS is designated as an alternative to PSAS for OGOs, we considered whether IFRS needs to be given precedence when applying the PSAS GAAP hierarchy.

As noted in the discussion under issue 3, there are a number of criteria in PS 1150 that should be considered when assessing sources other than the primary source of GAAP. However, there is no hierarchy or ordering of sources set out in PS 1150. Instead, PS 1150 establishes an overall framework for the exercise of professional judgment. In our view, as long as ASC 980 meets the criteria in PS 1150, we believe that it is an acceptable alternative source that may be considered by the IESO in establishing its accounting policy for rate-regulated activities. Different entities reporting under PSAS thus may reasonably choose different paths under PS 1150 when dealing with transactions or events that are not addressed with in the primary source.

Accordingly, we believe that there is no requirement for IESO to consider IFRS as the only alternative source other than the primary source of GAAP in its application of PS 1150.

Paragraph 11 of the *Introduction to Public Sector Accounting Standards* ("Introduction") states:

"These standards apply to all public sector entities that issue general purpose financial statements unless:

- (a) specifically directed or permitted to use alternative standards by PSAB, or*
- (b) limited in applicability as outlined in the individual Sections.*

When applying the CPA Canada Public Sector Accounting (PSA) Handbook, where the standards are silent on an issue, public sector entities should apply GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150."

Based on PS 1150.08 (a) and (b), in the absence of a specific source in Canada that provides alternative guidance for the accounting for the economic effects of rate-regulated activities, the management of IESO and we have concluded that a Canadian rate-regulated entity is permitted to use ASC 980 as a source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize.

"PS1150.08 "A public sector reporting entity consults sources other than primary sources of GAAP to assist in selecting accounting policies and disclosures only when these sources comply with paragraph PS 1150.05. The public sector reporting entity evaluates sources in selecting the appropriate accounting policies and disclosures based on all of the following criteria:

- (a) The specificity of the source — A source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize.*
- (b) The authority of the issuer or author — A source issued by an accounting standard setter in its own jurisdiction is likely to be more relevant than a source issued by others in the same jurisdiction."*

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As noted above, management of the IESO and we believe it is appropriate for the IESO to reference the private sector guidance when applying the GAAP hierarchy as PSAS does not provide detailed guidance on regulatory accounting. It should also be noted that the IESO's activities and mandate, including its regulated activities, are commercial in nature and IESO derives all of its revenue from those activities.

The CPA Handbook, Accounting has two accounting frameworks for commercial oriented organizations: IFRS and ASPE. ASPE defines a rate-regulated entity, provides guidance on certain aspects of the disclosure and presentation of information in the financial statements of rate-regulated entities through AcG 19 *Disclosures by entities subject to rate regulation*, and provides specific guidance under four Sections (3061, 3465, 3475 and 3850). ASPE provides no guidance on the recognition of regulatory assets and liabilities, though in accordance with AcG 19 par. 7 entities must disclose such balances if they are recognized. IASB has not completed their project on rate-regulated activities and current standards only include an interim standard allowing an entity within its scope to continue to account for rate-regulated activities in a manner consistent with its pre-IFRS accounting framework. See the further discussions on Canadian accounting standards at issue 1.

It is important to note that rate-regulated entities that prepare their general purpose financial statements in accordance with ASPE (e.g. the three Fortis subsidiaries in Ontario), as well as those rate-regulated entities that are eligible to elect to apply the requirements of IFRS 14 and elected to do so when they adopted IFRS, generally all recognize the economic effects of rate regulation in accordance with ASC 980, through the GAAP hierarchy in Section 1100 in ASPE and IFRS 14 in IFRS.

The relevance of private sector regulatory accounting principles to a government entity, was also identified in the basis of conclusions for the issuance of FAS 71. Paragraph 64 of the Basis for Conclusions of FAS 71 issued in 1982 noted that a number of U.S. governmental utilities believed that users' emphasis on comparability between investor-owned utilities and governmental utilities supported the continuation of the recognition of the economic effects of rate regulation for governmental utilities. As mentioned earlier, as from 2011 GASB has adopted the guidance of ASC 980 in GASB 62.

"A number of governmental utility respondents to the Exposure Draft asked that governmental utilities be included within the scope of this Statement. They noted that many governmental utilities have been guided by the same accounting practices and standards as investor-owned utilities in their general-purpose financial statements, and they expressed the view that users' emphasis on comparability supports continuation of that practice. In their view, the Board's decision not to address governmental utilities in this Statement should not preclude them from applying it. The Board agreed with those respondents and modified paragraph 5(a) so as not to preclude application by governmental utilities with rates set by their own governing board."

- 10. While it could have adopted IFRS as an "other government organization", it would be a first-time adopter and does not have a past practice of using rate-regulated accounting so it cannot adopt IFRS 14, Regulatory Deferral Accounts.**

We disagree with the above statement as the financial statements for the market accounts have included regulatory assets and liabilities for a number of years.

The IESO's 2016 financial statements included for the first time the assets and liabilities related to the market participants. These assets and liabilities included regulatory assets and liabilities that were also recognized in the market participants' financial statements. These variance accounts, which relate to the RRRP, RPP and OESP programs, met and continue to meet the recognition criteria in ASC 980.

As a result of the inclusion of the market accounts in the IESO's financial statements, which include regulatory assets and liabilities, should the IESO meet the GBE criteria or take the option offered to OGOs to use IFRS, then IESO would then be permitted to adopt IFRS 14 as it also meets the scope criteria in IFRS 14 paragraph 5 as follows:

"An entity is permitted to apply the requirements of this Standard in its first IFRS financial statements if and only if it:

(a) conducts rate-regulated activities; and

(b) recognised amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP."

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11. Has IESO been self-sustaining for the past years?

The management of the IESO believes that IESO is a self-sustaining entity. IESO does not have share capital and does not receive transfers or subsidies from the Province of Ontario. Based on management of the IESO, although the IESO currently has a note payable and a credit facility from the OEFC for corporate purposes, the IESO would be able to obtain similar sized facilities from a third-party financial institution. TD Bank had previously provided a corporate line of credit, which was replaced by the current OEFC line of credit. As the OEFC interest rate was lower than TD's, IESO has decided to utilize the OEFC line based on economic considerations. It should also be noted that the IESO currently has third party credit ratings from Moody and DBRS, which provide banks/lenders information on the IESO's creditworthiness status. The following is an extract from the note 7 of the IESO's 2016 annual report:

"Note payable to Ontario Electricity Financial Corporation (OEFC)

In April 2014, the IESO entered into a three-year note payable with the OEFC. The note payable is unsecured, bears interest at a fixed rate of 2.046% per annum and is repayable in full on April 30, 2017. Interest accrues daily and is payable in arrears semi-annually in April and October of each year. As at December 31, 2016, the note payable to the OEFC was \$90.0 million (December 31, 2015 – \$90.0 million).

For the year ended December 31, 2016, the interest expense on the note payable was \$1,841 thousand (2015 \$1,841 thousand).

Credit facility

The IESO has an unsecured credit facility agreement with the OEFC, which will make available to the IESO an amount up to \$95.0 million. Advances are payable at a variable interest rate equal to the Province of Ontario's cost of borrowing for a 30-day term plus 0.50% per annum, with draws, repayments and interest payments due monthly. The credit facility expires April 30, 2017. As at December 31, 2016, no amount was drawn on the credit facility (December 31, 2015 – \$nil).

For the year ended December 31, 2016, the interest expense on the credit facility was \$nil (2015: \$279,000)."

We set out below our consideration of the criteria to meet under PSAS for a self-sustaining entity.

PSAS, Section 1300	Criteria met?
<p>.30 A government business enterprise should, in the normal course of its operations, be able to maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity. These revenues include not only amounts from the sale of goods and services, but also transfers received from other governments or sources outside of the government reporting entity.</p> <p>PS 3410.04 defines government transfers as follows:</p> <p><i>"Government transfers are transfers of monetary assets or tangible capital assets from a government to an individual, an organization or another government for which the government making the transfer <u>does not</u>:</i></p> <p><i>(a) receive any goods or services directly in return, as would occur in a purchase / sale or other exchange transaction;</i></p> <p><i>(b) <u>expect to be repaid in the future, as would be expected in a loan; or</u></i></p> <p><i>(c) <u>expect a direct financial return, as would be expected in an investment.</u>" (Emphasis added)</i></p>	<p>Met. IESO does not receive government transfer payments, as defined in PS 3410.04, from the Province. All its costs are to be recovered from the customers through the market participants after IESO's budget's review and approval has been obtained from the Ministry of Energy and the OEB.</p> <p>For each credit facility with the OEFC, the IESO has a credit agreement document with commercial term clauses. As noted in the note 7 to the IESO's 2016 annual report, these facilities are subject to repayment terms and provide a direct financial return to the OEFC.</p>
<p>.31 When determining if an organization can maintain its operations and meet its liabilities with revenues received from outside of the government reporting entity, the</p>	

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PSAS, Section 1300	Criteria met?
following factors should be considered:	
(a) the organization's history of maintaining its operations and meeting its liabilities;	Met. IESO does not rely on the Province. Similar to all other rate-regulated entities, IESO relies on its ability to recover all its costs from the customers through the market participants.
(b) whether the organization would continue to maintain its operations and meet its liabilities without relying on sales to, or subsidies in cash or kind from, the government reporting entity;	Met. IESO does not receive subsidies in cash or in kind, nor does it sell any goods or services to the Province of Ontario.
(c) past, present and future economic conditions within which the organization operates; and	Met. The FHP allows IESO to recover all its costs incurred related to the FHP from the customers through the market participants.
(d) whether the organization has realistic and specific plans that show how it expects to be able to maintain its operations and meet its liabilities in the future.	Met. The FHP allows IESO to recover all its costs incurred related to the FHP from the customers through the market participants. The variance account related to the FHP will be sold, on a monthly basis, to a Trust to be established by the OPG. Any variance accounts not sold to the Trust, will be kept in the IESO's variance account and be recoverable in the future via OEB approved rate.

12. Are regulatory assets considered intangible assets?

No. There are two fundamental bases for this conclusion.

First, we note that the economic impacts of rate regulation are not recognized under US GAAP as intangible assets since the FASB has specific guidance dealing with this type of asset. An entity that meets the recognition criteria in ASC 980-10-15-2 applies ASC 980, not the intangible assets standard under US GAAP. The guidance in ASC 980-10-15-2 requires an entity to apply ASC 980 in its general-purpose external financial statements if its regulated operations meet all of the following criteria:

- "(a) The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.*
- (b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form.*
- (c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs."*

Since IESO's regulated operations meet the criteria mentioned in 980-10-15-2, it can apply ASC 980. Within ASC 980, there are no references that indicate that the assets recognized under the topic are intangible assets. Furthermore, there are no references in ASC 350 *Intangibles-Goodwill and Other* that indicate that assets recognized under ASC 980 are intangible assets. Within IFRS and Parts II and V of the CPA Handbook, there are no references that indicate that regulatory assets are considered intangible assets.

Second, and following from the discussion and conclusions at issue 7 above, we considered the definitions of financial and non-financial assets under PSAS. An intangible asset would need to be a non-financial asset. The definitions of financial assets and non-financial assets in PS 1000.39 and .42, respectively, are:

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"Financial assets are assets that could be used to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations."

"Non-financial assets are acquired, constructed or developed assets that do not normally provide resources to discharge existing liabilities, but instead:

- (a) are normally employed to deliver government services;*
- (b) may be consumed in the normal course of operations; and*
- (c) are not for sale in the normal course of operations."*

Regulatory assets cannot be consumed in the normal course of operations. However, by virtue of the fact that they represent a financial claim on customers that has arisen due to the fact that the OEB requires the amount to be collected in a future period, a regulatory asset will be used to discharge existing liabilities either to the generators of electricity or the financial institution financing the obligation to the generators of electricity. Therefore, we believe that regulatory assets meet the definition of financial assets under PSAS. This is also supported by PS 1000.42(b), which states that *"a financial asset is any asset that is a realizable asset that is convertible to cash."*

Although intangible assets are mentioned in PSAS, it does not offer a definition. As mentioned in PS 1150.25 and PS 1000.57 and .58, intangible assets are considered non-financial assets and since PSAS has no appropriate public sector recognition and measurement criteria for their recognition, they are not recognized as assets. The costs, benefits and economic value of regulatory assets can be reasonably and verifiably quantified, as they represent the difference between the amount paid to a supplier for goods or services received and the amount collected from the customers through the market participants.

25. *"Certain non-financial resources are, however, not given accounting recognition as assets in government financial statements. For example, all government intangibles, and all natural resources and Crown lands that have not been purchased by the government, are not given accounting recognition in government financial statements. A government's non-financial assets, as defined in FINANCIAL STATEMENT CONCEPTS, Section PS 1100, comprise the recognized non-financial resources of a government."*

57. *"Purchased natural resources and Crown lands are recognized in government financial statements. However, when natural resources and Crown lands have been inherited by the government in right of the Crown and have not been purchased, they are not given accounting recognition as assets in government financial statements. These items are not recognized as assets because the costs, benefits and economic value of such items cannot be reasonably and verifiably quantified using existing methods. Similarly, art and historic treasures are also not recognized as assets."*

58. *"In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements. The intangible often called "human capital" that embodies the talent or intellectual capital of government employees is not recognized as an asset under existing accounting principles." (Emphasis added)*

It is worth noting that the IASB has an ongoing project on rate-regulated activities and are currently developing an accounting model to provide a principle-based framework for recognizing regulatory assets (see discussion under issue 7 above).

13. Does the IESO meet the first criteria in ASC 980-10-15-2 related to the regulator?

Yes. The criteria for the regulator (i.e. the OEB) is included in the first criteria of ASC 980-10-15-2 which states:

"The enterprise's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers."

Although the Basis for Conclusions included in FAS 71 have not been incorporated into the Accounting Standards Codification, they provide useful information for the understanding of the Standard.

Paragraphs 60 to 64 of FAS 71 relate to the scope and, in particular, to the role of the regulator.

"60. The Discussion Memorandum discussed regulation of various industries, and it asked whether a Board pronouncement should identify specific industries that are affected. Most respondents indicated that

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applicability of an FASB Statement on rate regulation should be specified by clearly describing the nature of the regulated operations to which it applies rather than by attempting to delineate specific industries. Some noted that changes in the political environment can cause changes in the nature of regulation. Accordingly, whether an industry meets the criteria for applicability might change over time. The Board agreed with those respondents and, accordingly, specified criteria that focus on the nature of regulation rather than on specific industries.

61. This Statement specifies the economic effects that result from the cause-and-effect relationship of costs and revenues in the rate-regulated environment and how those effects are to be accounted for. The nature of those effects led to the criteria for applicability of this Statement (paragraph 5).

62. The first criterion is the existence of third-party regulation. That criterion is intended to exclude contractual arrangements in which the government, or another party that could be viewed as a "regulator," is a party to a contract and is the enterprise's principal customer. For example, the normal Medicare and Medicaid arrangements are excluded from the scope of this Statement because they are contractual-type arrangements between the provider and the governmental agency that is responsible for payment for services provided

63. Some respondents to the Exposure Draft indicated that cooperative utilities should be included in the scope of this Statement. They observed that some cooperative utilities' rates are subject to third-party regulation, but others' rates are set by their own governing board. The governing board is elected by the members of the cooperative, and it has the same authority as an independent, third-party regulator. In their view, the difference between cooperative utilities that are subject to third-party regulation and those that are not does not justify different accounting. The Board agreed with those respondents, and modified the first criterion to include enterprises with rates established by their own governing board providing that board is empowered by statute or by contract to establish rates that bind customers.

64. A number of governmental utility respondents to the Exposure Draft asked that governmental utilities be included within the scope of this Statement. They noted that many governmental utilities have been guided by the same accounting practices and standards as investor-owned utilities in their general-purpose financial statements, and they expressed the view that users' emphasis on comparability supports continuation of that practice. In their view, the Board's decision not to address governmental utilities in this Statement should not preclude them from applying it. The Board agreed with those respondents and modified paragraph 5(a) so as not to preclude application by governmental utilities with rates set by their own governing board."

It is also important to note that both Hydro One and OPG are classified as Government Business Enterprises and are reporting under IFRS in their consolidated financial statements, are consolidated by the modified equity method into the province's books, are regulated by the OEB, and their respective regulatory assets and liabilities are reported in the province's books.

In considering the applicability of this guidance, management of the IESO and we have concluded that the IESO's regulated operations meet the first criteria related to the regulator.

14. Are regulatory assets considered deferred costs under PSAS?

No. The regulatory assets recorded by IESO are not deferred costs. Costs that meet the recognition of an expense are recorded as such, and costs that meet the definition of a tangible capital asset have been recorded as such. A deferral model would have IESO capitalize costs rather than expense or record as other assets. Regulatory assets record an asset based on the right to collect rates in the future.

While IFRS 14 refers to these as "regulatory deferral accounts", they are not consistent or synonymous with what is being discussed by the Framework Task Force or a deferral model. See discussion below related to the conceptual framework under PSAS.

The proposed conceptual framework under PSAS

That being said, even if regulatory assets were considered deferred costs, the concept of deferrals is supported in PSAS under both existing standards and the Board's conceptual framework for future standards. PSAB's conceptual framework Discussion Paper 3, Conceptual Framework Fundamentals and the Reporting Model, indicated that stakeholder feedback "noted that the asset and liability definitions should allow some deferral/matching, in particular, in relation to transfers received".

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The discussion paper noted that developing a “solid, objective basis for deferring inflows and outflows to future periods” was a key objective influencing stakeholder views on an appropriate financial reporting model, and suggested that deferrals that meet the definitions of assets and liabilities should be allowed.

In support of the conceptual framework, a report from PSAB’s Joint Working Group comprised of selected PSAB members and deputy ministers of finance recommended that:

“...expansion of the description/definition of liabilities will address liabilities associated with exchange transactions that originate from deferred income which are not currently addressed in the PSA Handbook. Alternatively, if these changes cannot be accommodated, new financial statement elements for deferred inflows and outflows (i.e., deferred revenue/expense) should be considered without recording the deferral directly to accumulated surplus/deficit as a means to avoid impacting the statement of operations.”

Consistent with the principles of the conceptual framework, the concept of deferrals is presently incorporated within certain sections of the PSAS, including:

- ***Development fees accounted for in accordance with Section PS 3100, Restricted Assets and Revenues.***
 - .11 Externally restricted inflows should be recognized as revenue in a government's financial statements in the period in which the resources are used for the purpose or purposes specified. An externally restricted inflow received before this criterion has been met should be reported as a liability until the resources are used for the purpose or purposes specified.*
 - .12 Income on externally restricted assets may or may not be restricted, depending on the terms of the agreement or legislation. If the provisions of the relevant agreement or legislation require that the income be restricted, then the revenue recognition principle in paragraph PS 3100.11 would apply. For example, governing legislation may stipulate that income on unspent development contributions also has to be used for development. Such income would be recorded as a liability until used for the purpose or purposes specified.*
- ***Government transfers meeting the three characteristics of liabilities in accordance with Section PS 3410, Government Transfers and Section PS 3200, Liabilities.***
 - .19 A transfer with or without eligibility criteria but with stipulations should be recognized by a recipient government as revenue in the period the transfer is authorized and all eligibility criteria have been met, except when and to the extent that the transfer gives rise to an obligation that meets the definition of a liability for the recipient government in accordance with LIABILITIES, Section PS 3200.*
 - .20 The determination under paragraph PS 3410.19 as to whether a liability would arise for a recipient government in relation to a transfer would be influenced by:*
 - (a) the stipulations of the transfer alone; or,*
 - (b) the stipulations of the transfer taken together with the actions and communications of the recipient government before the financial statement date;*
 - and whether either set of circumstances would create an obligation that meets the definition of a liability in LIABILITIES, Section PS 3200. Paragraph PS 3410.08 provides guidance for evaluating the extent to which transfer terms meet the definition of stipulations for the purposes of this Section.*
- ***Accounting for retirement and postretirement benefits using an accrued benefit method under PS 3250 and PS 3255***
 - PS 3250***
 - .022 Accounting for retirement benefits on the basis of employee services reflects the fact that there is no obligation for an employee when hired and that an obligation for retirement benefits exists as the employee renders service. The accounting task is to determine how to attribute the cost of the total retirement benefits promised to each period of employee service.*
 - .023 For defined benefit plans, there are two main groups of actuarial cost methods. They are level cost methods and accrued benefit methods. Under the level cost methods, retirement benefit expenses are computed in such a manner as to produce a total current period benefit cost that remains constant, either in absolute dollars or as a percentage of salary, throughout an employee's service life. However, level cost*

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methods are not recommended for accounting purposes because they do not reflect the cost of benefits earned by employees to the financial statement date.

.024 Under the accrued benefit methods, a distinct unit of retirement benefit is associated with each year of employee service rendered to the financial statement date. The actuarial present value of that unit of benefit is computed separately for the period during which it accrued. These methods are recommended because they reflect more directly the cost of retirement benefits earned by employees to the financial statement date.

.025 An accrued benefit method should be used to attribute the cost of retirement benefits to the periods of employee service.

PS 3255

.06 Post-employment benefits, compensated absences and termination benefits are liabilities of a government. Accounting for all benefit plans is important because many governments have accumulated significant related liabilities. The fundamental accounting task is to determine the amount of the liability for these benefits and to what periods to attribute the costs.

.24 For a separately measured plan providing post-employment benefits or compensated absences that do not vest or accumulate, a government should recognize any actuarial gain or loss:

- (a) immediately, in the period in which it arises; or*
- (b) over a period linked to the type of benefit.*

PSAB's exposure draft on the proposed asset retirement obligation section PS 3280 also incorporates the concept of deferral in the recognition and allocation of asset retirement costs, noting specifically that:

.25 Upon initial recognition of a liability for an asset retirement obligation, a public sector entity should recognize an asset retirement cost by increasing the carrying amount of the related tangible capital asset (or a component thereof) by the same amount as the liability.

.26 The public sector entity should allocate the asset retirement cost to expense in a rational and systematic manner. A rational and systematic manner could include amortization over the remaining useful life of the tangible capital asset (or a component thereof), or some other appropriate period depending on the use of the related asset.

Consequently, PSAS supports deferrals that meet the definition of an asset or liability in accordance with PS 1000, *Financial statement concepts*; PS 3200 *Liabilities*; and PS 3210 *Assets*.

15. Should the transactions related to the market accounts be recorded in IESO's books? If so, should they be recorded on a gross or net basis?

Management of the IESO and we believe that the transactions related to the market accounts should be recorded in IESO's books. Management of the IESO and we believe that the revenue and expenses should be presented on a net basis as IESO is acting as an agent for the market participants, but the assets and liabilities cannot be presented on a net basis and must be presented on a gross basis as they do not meet the netting criteria of 3450 *Financial Instruments* in paragraphs .059 and .066(b).

PS 3450 Financial Instruments

The assets and liabilities relating to the market transactions include cash restricted for the market activities, revolving line of credit, interest receivable and payable, amounts due to and due from market participants, HST receivable, and regulatory assets and liabilities related to the RRRP, RPP and OESP programs regulated by the OEB.

Paragraph 11 of PS 3450 states that "A government should recognize a financial asset or a financial liability on its statement of financial position when, and only when, a government becomes a party to the contractual provisions of the instrument."

Paragraph 9 of PS 3450 states that "A contract establishing a financial instrument creates, at its inception, rights and obligations to receive or deliver economic benefits. The financial assets and financial liabilities portray these rights and obligations in financial statements. The assessment of those benefits is a measurement question and does not affect the timing of recognition. Recognition occurs when a government becomes a party to a financial instrument or non-financial derivative contract."

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Based on the above guidance, since the IESO is responsible for procuring supply, capacity and conservation measures and as the IESO entered into these energy contracts with the generators, management of the IESO and we believe that these contracts meet the definition of financial instruments.

Based on the above guidance, the IESO should recognize these assets and liabilities on the statement of financial position.

Should these assets and liabilities be presented on a gross or net basis? Based on PS 3450, since the counterparties are different and do not realize the asset and settle the liability simultaneously, we believe that these assets and liabilities cannot be presented on a net basis as they do not meet the netting criteria in paragraphs .059 and .066(b).

Paragraph 059 states "A financial asset and a financial liability should be offset and the net amount reported in the statement of financial position when, and only when, a government:

- (a) currently has a legally enforceable right to set off the recognized amounts; and*
- (b) intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously."*

Since the counterparties are different, there are no enforceable right to set off between the counterparties. Paragraph .066 (b) states:

"The conditions set out in paragraph PS 3450.059 are generally not satisfied and offsetting is usually inappropriate when:

- (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure but involve different counterparties."*

IFRIC project on Centrally Cleared Client Derivatives

The IFRS Interpretations Committee ("IFRIC") has addressed a similar issue over the past few months. The IFRIC received a request to clarify the accounting for centrally cleared client derivative contracts from the perspective of the clearing member (see Appendix J). The wording for the final agenda decision is as follows:

"The Committee concluded that the clearing member first applies the requirements for financial instruments. More specifically, the Committee observed that:

- a) if the transaction(s) results in contracts that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement, then the clearing member applies the recognition requirements in paragraph 14 of IAS 39 to those contracts. The clearing member presents assets and liabilities separately applying IAS 39 in the statement of financial position, unless net presentation is required pursuant to the offsetting requirements in paragraph 42 of IAS 32.*
- b) If the transaction(s) is not within the scope of IAS 39 and another IFRS Standard does not specifically apply, only then would the clearing member apply the hierarchy in paragraphs 10–12 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to determine an appropriate accounting policy for the transaction(s)."*

The circumstances are analogous, the relevant guidance on recognition and netting is consistent between IFRS and PSAS in this respect and so the IFRIC conclusion is consistent with IESO's accounting treatment for the recognition and netting of financial assets and liabilities as a result of entering into contractual arrangements.

14. "An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument.

42. A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

- a) currently has a legally enforceable right to set off the recognised amounts; and*
- b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.*

Other ISO entities in North America

7 of the other 8 entities recognize the assets and liabilities of the market participants on a gross basis and their revenue on a net basis (see Appendix I). AESO (previously named Power Pool of Alberta) is the only entity that does not recognize the assets and liabilities of the market participants.

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PWC's previous analysis

As the first auditor of IESO, PWC performed in 2003 an accounting analysis as to how the transactions with the market participants should be included in the IESO's financial statements. The accounting analysis was performed under Part V and only addressed the revenue recognition related to the market transactions in the corporate accounts of the IESO (previously named IMO). The IESO's accounting analysis was not updated when PS 3450 *Financial Instruments* was released in 2011. The following is an extract from the PWC report dated February 27, 2003:

"The principal source of authoritative literature for Canadian GAAP are the Accounting Recommendations issued by the Accounting Standards Board, as set out in the Handbook of the Canadian Institute of Chartered Accountants (CICA). Where an emerging topic is not addressed in a CICA Handbook Section, the Accounting Standards Board may issue guidance by way of an EIC Abstract. While EIC Abstracts are less authoritative than CICA Handbook Sections, financial statements are expected to be prepared in accordance with such guidance.

We made specific reference to CICA Handbook Section 1000 "Elements of Financial Statements" and EIC 123 "Reporting revenue gross as a principal versus net as an agent". Relevant extracts from this guidance are given below"

The analysis performed by PWC assessed how the revenue related to the market transactions should be recognized using EIC 123 "Reporting revenue gross as a principal versus net as an agent" ("EIC 123"). It should be noted that EIC 123 does not address if, when and how the related receivables and payables should be recognized in the financial statements.

PWC provided its conclusion in the Executive Summary:

"We agree with management's position that physical electricity sales and purchases as well as legislated charges and rebates are transactions for the account of market participants which should not be reported in the IMO's corporate financial statements."

PWC also reviewed the following industry precedents:

"We examined the publicly available financial statements of the following similar corporations:

Power Pool of Alberta (now called AESO)

We reviewed the 2001 Annual Report of this entity. The Power Pool of Alberta recognizes as revenue only the equivalent of the systems fees received by the IMO. The Annual Report and financial statements do not disclose the value of market transactions undertaken through the Power Pool.

PJM Interconnection LLC (USA)

We reviewed the 2001 Annual Report of this entity. PJM recognizes as revenue only service fees and reimbursements of operating expenses, and not the value of market transactions.

Although not recognized in the financial statements, PJM has provided disclosure of the value of settlements processed by the market. This disclosure is given in Management's Discussion & Analysis."

As a result, PWC concluded that transactions in the market accounts should not be reflected on a gross basis in IESO's profit and loss statement.

We note that PJM's assets and liabilities related to the market transactions are shown on their balance sheet, and the revenue and expenses are shown on a net basis in their consolidated financial statements for a number of years. PJM also recognizes regulatory assets and liabilities.

16. Does ASC 980-10-15-7 (a) forbid the IESO to recognize the economic effects of rate regulation in times of price controls imposed by government?

No, management of the IESO and we believe that the Ontario Fair Hydro Plan, Act 2017 ("FHP") is not a price control and hence is not subject to the scope limitation discussed in ASC 980-10-15-7 (a) (or paragraph 8 of IAS 71) and paragraph 70 of the Basis for Conclusions of IAS 71.

980-10-15-7 (a) states "Accounting for price controls that are imposed by governmental action in times of emergency, high inflation, or other unusual conditions, or accounting for contracts in general. However, if the terms of a contract between an entity and its customer are subject to regulation and the criteria of

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paragraph 980-10-15-2 are met with respect to that contract, the guidance in this Topic shall apply.”

Paragraph 70 of the Basis for Conclusions of FAS 71 states *“The first scope limitation of paragraph 8—excluding accounting for price controls imposed by governmental action in times of emergency, high inflation, or other unusual conditions—was included in the Discussion Memorandum. Price controls imposed in periods of unusual conditions are not expected to be applied consistently over an extended period. Indeed, their duration usually is limited by statute. In that environment, assurance of future benefits cannot be provided by probable future actions of the price control regulator because that regulator may not exist at a given future date.”* (Emphasis added)

Therefore, there are two issues – first, are such economic events actually “price controls” and, second, if they are not, do such transactions meet the requirements of ASC 980 to be recognized in the regulated entity’s general purpose financial statements.

With respect to the first issue, the OEB’s rate setting process does not represent “price controls” as such term is intended to be applied in the standard. We note they have not been imposed in times of emergency, high inflation or other unusual conditions. Rather they have been applied in managing the timing of charging cost increases through to customers for the purchase of energy. To conclude that the instant case is one of “price controls” would result in a conclusion that all rate setting processes are “price controls” which clearly is not the case.

With respect to the second issue, and notwithstanding the conclusion on the first, we note that the regulatory actions result in the criteria in ASC 980 for recognition being met.

In accordance with the Legislation for the FHP, certain costs related to the PPAs in place will be deferred and the recovery of those costs will be included in a period other than the period in which the costs would be charged to expense. In fact, the difference between the amounts paid to the generators and the amounts collected from the customers through the market participants will be recorded by the IESO in a pre-approved variance account. The OEB will regulate the timing of the recovery and set the rates to ensure that the IESO can fully recover the variance account relating to the PPA costs. Since the IESO will have certainty as to the recoverability of the variance account relating to the PPA costs, it is not subject to the scope limitation.

The payment by ratepayers for the PPAs are currently subject to Decisions and Orders issued by the OEB. The variance accounts approved by the OEB for the RRRP, RPP and OESP programs have been discussed earlier. The FHP, will create a variance account similar to the RPP and the rate for the recovery of the PPA costs will continue to be set by the OEB to ensure the IESO can fully recover the variance account.

980-10-05-8: *“Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity’s economic resources or obligations. In other words, the economic effect of regulatory decisions is not the mere existence of regulation—is the pervasive factor that determines the application of GAAP.”* (Emphasis added)

17. Why don’t other rate-regulated entities under PSAS record the economic impacts of rate regulation?

Since we do not have access to the facts and circumstances related to the rate-regulated entities reporting under PSAS, it is difficult to provide a definitive view. However, as discussed in response to issue 3, it should be noted that it is a choice whether or not to use the GAAP hierarchy under PSAS to apply ASC 980 which may not have been taken by these entities. In addition, as discussed in response to issue 9, different entities reporting under PSAS may reasonably choose different paths under PS 1150 when dealing with transactions or events that are not addressed within the primary source. Furthermore, in order to recognize the economic effects of rate regulation, these entities must meet the scope criteria in ASC 980-10-15-2, especially (b) which states *“The regulated rates are designed to recover the specific entity’s costs of providing the regulated services or products.”*

Based on a review of the financial statements of three rate-regulated entities in the Territories (Northwest Territories Hydro Corporation and its subsidiary Northwest Territories Power Corporation and Qulliq Energy Corporation), it is possible that these entities have concluded that they do not meet the criteria in ASC 980-10-15-2 (b) since they have no certainty of recovering their costs of providing services as they receive significant financial assistance from their government.

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Northwest Territories Hydro Corporation and its subsidiary Northwest Territories Power Corporation

Extract from note 1.c) of the 2015 Financial statements of both Northwest Territories Hydro Corporation and its subsidiary Northwest Territories Power Corporation.

"Economic dependence

NTPC has historically been able to maintain its operations and meet its liabilities through the rate regulation process without receiving any significant financial assistance from the GNWT and has been classified as a government business enterprise (GBE). Over the past few years, in order to mitigate rate increases to customers, the GNWT has provided larger increases in subsidization to customers through rates by providing direct contributions to NTPC to apply against those rate increases. As a result of this government driven policy, NTPC is economically dependent on the GNWT to maintain its operations and meet its liabilities. It is expected that the ongoing operations of NTPC will depend on continued financial support from GNWT. This economic dependence resulted in NTPC being classified as an other government organization (OGO), beginning in fiscal 2015. The financial impacts of this change in classification from GBE to OGO are described in Notes 2 and 24." (Emphasis added)

Qulliq Energy Corporation

Extract from note 1 of the 2015-2016 annual report of Qulliq Energy Corporation.

"Economic dependence The Corporation is economically dependent on the Government of Nunavut which, directly and indirectly, accounts for the majority of the Corporation's sales of power. The Government of Nunavut also guarantees the Corporation's debt."

The facts and circumstances of IESO are different as IESO does not receive transfers or subsidies from the Province of Ontario to cover its costs. IESO relies on its ability to recover the costs from the customers through the market participants.