

May 5, 2011

Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
27<sup>th</sup> Floor  
2300 Yonge Street  
Toronto, ON M4P 1E4

*Via web portal and by courier*

Dear Board Secretary:

**Re: Board File No. EB-2008-0408; Staff Discussion Paper  
Transition to IFRS – Implementation in an IRM Environment**

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (Distributors). The EDA represents the interests of the over 80 publicly and privately owned Distributors in Ontario.

We appreciate the Board staff's considerable efforts in the preparation of the staff discussion paper that was released recently in the above referred matter.

The EDA's comments on the Board staff recommendations in respect of the issues arising from the transition to IFRS, particularly for utilities in an IRM environment, are provided in the attached submission. This submission has been prepared in consultation with EDA members.

The EDA would like thank the Board for giving the opportunity to provide comments on this important initiative and looks forward to working with Board members and staff in this regard.

Yours truly,



Maurice Tucci  
Policy Director, Distribution & Regulation

Attached: EDA submission

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**EDA's Comments on the Board Staff Proposals on Issues Arising from the Transition to IFRS for Utilities in an IRM Environment**

**Issues Arising on Transition to IFRS**

**Issue 1: How to recognize accounting changes between CGAAP and modified IFRS in an IRM application? Specifically, for Distributors that have rebased under CGAAP but subsequently have adopted IFRS, and are filing an IRM application to seek an adjustment through Z-factor or Y factor; or incremental capital module (ICM); or off-ramp (IRM2); or seeking disposition of Group 2 deferral and variance account balances as part of the annual review process; or reports an instance of ROE exceeding the dead band (positive or negative).**

We agree with the Board staff proposal that the financial information supporting the specific request in the IRM application for any of the elements described above, must be provided under CGAAP, and that the rate adjustments should be made on the basis of the CGAAP filing until the utility's first rebasing under Modified IFRS (MIFRS).

The EDA supports the notion that reconciliation would be required for the CGAAP-based financial information to the relevant information in the last annual RRR reporting provided under modified IFRS. However, since maintaining accounts under two sets of standards over an extended period of time would be difficult, we believe that providing reconciliation at a higher hierarchical level ( i.e., at the account level) would certainly be possible, but reconciliation at the transactional level would be highly impractical and become prohibitively expensive, if required. Therefore, we recommend that only one time reconciliation be required from distributors at the account level.

In addition, we also agree with the staff proposal that no third party assurance should be required for the reconciliations since the numbers provided would be subject to scrutiny during the IRM proceeding or the next cost of service rates case.

**Issue 2: How should the differences between costs recorded in the balance sheet accounts under MIFRS and costs built into rates be treated? Should they be recovered from or refunded to ratepayers?**

**For PP&E components of rate base including associated intangible assets**

We agree with the staff proposal that the Board approve a deferral account to capture the differences in costs associated with Property, Plant and Equipment components of the rate base, including the related intangible assets.

The mechanism proposed in the staff paper for the recovery or refund of changes in costs for PP&E items is also considered appropriate because it addresses the impact of transition over the full period of IRM.

We support the staff recommendation that , when setting rates on MIFRS basis, a utility's approved return (i.e., Return on equity) should be calculated using MIFRS rate base that includes the unamortized balance in the deferral account, because the unamortized balance in the deferral account arose from in-service PP&E.

We support the staff's view that there should be no carrying charges added to the balance accruing in this deferral account because the amounts recorded in the account would have no effect on rates under IRM until rebasing.

We also agree with the proposal that the amount recorded in the deferral account may be approved by the Board for clearance in full amount at the time of utility's first rebasing under MIFRS, despite the fact that some portion of the amount is based on a forecast. This proposal is reasonable because there would be no further need to record amounts in the account since the rate base would be set in MIFRS along with the adjustment to the rate base.

**For Pension and Other Post Employment Benefits (P&OPEB)**

We recommend establishing a generic account to capture P&OPEB differences driven by the transition to IFRS as it would eliminate distributors applying to the Board on an individual basis. This will not only reduce the administrative burden on the Board for approving individual distributor applications, but also allow distributors to use the account only if they experience an adjustment upon transition to IFRS for P&OPEB related items.

**Issue 3: Should the difference between PILs amounts allowed in rates and the actual PILs payments arising from IFRS transition be captured in a deferral account?**

We agree with the Board staff that there would be practical difficulties in isolating the IFRS impacts on statutory taxes payable on a going forward basis and in addition, the particulars and the significance of this potential effect are not yet known. Although additional guidance in this regard is not feasible for now, we recommend that the OEB continue to monitor PILS related developments during the IFRS transition period to determine if further guidance is warranted at that time.

**Issue 4: Should the Board permit USGAAP for rate applications /RRR reporting?**

The EDA supports the Board staff position to neither encourage nor discourage the use of US GAAP and permit utilities wishing to file a cost of service application under USGAAP to file a letter with the Board for consideration.

## **Issues Arising after Adoption of Modified IFRS**

**Issue 5: After rebasing under modified IFRS, will utilities need a generic deferral account for recording changes resulting from new IFRS standards or changes in existing IFRS standards arising during an IRM regime?**

We agree with the Board staff recommendation that there is no need to establish a generic deferral account at this time as the impact of further changes in standards is not known at this time. However, we strongly recommend that the Board should monitor the changes in standards from time to time and assess the likely impact so as to consider creating a generic account at that time, if required.

**Issue 6: Should there be a generic variance account to mitigate volatility in certain expenses arising from the application of IFRS rules? In particular, differences in depreciation or amortization expense caused by changes in estimated:**

- useful life of in-service PP&E or intangible assets included in rate base; or
- gains and losses arising from early retirement of in-service assets; and
- differences in pension and post-employment benefit expenses

We agree that neither the Board nor the distributors have the data as to the materiality of this volatility.

However, distributors will be required to recognize a change in the useful life of an asset for accounting purposes under IFRS which would lead to irreconcilable differences between the rate base and the audited net book value of PP&E items. The divergence between the rate base and the net book value will continue to exist unless and until the rate base values are brought in line with the values in the financial statements at the next rebasing. In order to be able to bring the rate base values in line with the financial statements, there is a need for a deferral account. Unless a deferral account is established to record the differences, any gain or loss that arises from the divergence during the IRM period would not be recoverable from or refunded to rate payers.

In addition, we believe a variance account would be required to capture losses arising on early retirement of in-service assets required for recognition under IFRS. The removal of the group depreciation method available under CGAAP will require an amount to be recorded for the retirement of assets on a more specific basis. Since utilities have no experience in forecasting the extent of losses arising from early retirement of in-service assets and the fact that most utilities are likely to encounter material difficulties in forecasting the extent of losses, it is recommended to establish a variance account to reduce the risk to utilities and ratepayers until the utilities gain more experience in forecasting the extent of losses arising from early retirement of in-service assets. In this regard, Board staff suggested that a defined sunset date of 2016 for recording variances in the deferral account because staff expects utilities to get experienced at forecasting the extent of losses by 2016. We do not agree with the proposed sunset date because utilities are not likely to get adequate experience at forecasting the losses by 2016 because of their likely schedules for rebasing under IFRS.

Furthermore, with the major changes in the offering for distribution system upgrades resulting from the requirements of the Green Energy Act to enable distributed generation, smart grid etc., a historical basis of experience for forecasting the early removal of in-service assets are not likely to represent a valid basis of predicting future retirements given the likely change in focus and purpose of distribution systems.

We believe the Board should establish a variance account to capture the differences in pension and post-employment benefit expenses caused by actuarial gains and losses after the adoption of IFRS. The IASB is in the final stages of issuing an amendment to IAS 19 that will require all entities to immediately recognize actuarial gains and losses. Therefore, during an IRM period all actuarial gains and losses will be attributable to the shareholder and may never be reflected in rates.

Therefore, we strongly recommend establishing separate generic deferral accounts to record the differences in depreciation or amortization expense as well as pension and post-employment benefits caused by changes in estimated:

- a) useful life of in-service PP&E or intangible assets included in rate base;
- b) gains and losses arising from early retirement of in-service assets; and
- c) actuarial gains and losses.

**Issue 7: The Board Report (of July 2009) requires utilities under IRM to provide a reconciliation of reported annual performance (RRR) to the same basis of accounting as that upon which the incentive framework was approved. Does this mean reconciliation would be required between RRR data under modified IFRS to CGAAP each year of an IRM period? Or is reconciliation for the first year of RRR reporting under MIFRS sufficient? What level of audit assurance should the Board require for this reconciliation?**

We agree with the Board staff proposal that Reconciliation is not required every year of an IRM period for all reported items required under RRR.

We support the notion that a one-time reconciliation should be performed by utilities between 2011 CGAAP financial statement figures and the 2011 IFRS financial statement comparative figures for submission to the Board with the RRR annual performance reporting for 2012. However, audit assurance for the reconciliation by an external auditor could be provided only at a higher hierarchical level and not at a detailed transactional level.

We also agree that one-time mapping of the 2011 USoA account balances and the 2011 IFRS audited financial statements comparative figures should be performed by utilities for submission to the Board with the RRR annual performance reporting for 2012. However, we believe mapping of accounts cannot reasonably be reviewed by external auditors, and therefore mapping of accounts should not require external audit assurance.

We do not agree with the staff proposal that requires external audit assurance for reconciliations provided each year for Group 1 deferral and variance accounts during IRM period, where distributors have not rebased under MIFRS. We believe external auditors would not be able to provide audit assurance for detailed account level reconciliation prepared by utilities. However,

if external audit assurance would be required for Group 1 deferral and variance accounts, the audit would become expensive and may not be appropriate for straight forward accounts such as Group 1 deferral and variance accounts.

We support the view that reconciliation would be required from all distributors for the balance in the deferral account created to record differences in PP&E items up to of the last historical year before rebasing under MIFRS. However, this would not require external audit assurance.

**Issue 8: Should the Board consider making adjustments to the IRM regime itself such as adjustments to thresholds for Z , Y factors; ICM, Off –ramps, ROE dead bands, and Thresholds for disposition of deferral and variance accounts?**

A few utilities are expected to rebase under MIFRS in 2011 for 2012 rates. These distributors will be subject to IRM regime under MIFRS for 2013 rates. Therefore, we strongly recommend that Board consider making adjustments to the IRM methodology as soon as possible.