

ONTARIO ENERGY ASSOCIATION ON BEHALF OF CLD+

CONSULTATION ON THE DEFERRAL ACCOUNT – IMPACTS ARISING FROM THE COVID-19 EMERGENCY: EB-2020-0133

June 11, 2020

To shape our energy future for a stronger Ontario.



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INTRODUCTION

1. On May 14, 2020, the Ontario Energy Board (“OEB”) announced the commencement of its policy proceeding to consult with stakeholders on the deferral account and associated sub-accounts it established relating to impacts arising from the COVID-19 emergency (the “Accounts”¹) and published the Draft Issues List. On May 28, 2020, the OEB hosted a preliminary stakeholder meeting to discuss the Draft Issues List. On June 4, 2020, the OEB published clarifications on matters discussed at the preliminary stakeholder meeting and outlined the next steps in the consultation process.
2. For this policy proceeding, the OEB encouraged stakeholders to coordinate their participation.² In that spirit, and in the interest of helping to expedite this process, the Ontario Energy Association (“OEA”) is providing written comments with respect to the Draft Issues List on behalf of the following member organizations: Alectra Utilities Corporation, Elexicon Energy Inc, Enbridge Gas Inc., Hydro One Networks Inc., Hydro Ottawa Limited, and Toronto Hydro-Electric System Limited (collectively, “CLD+”). The CLD+ serves over 70% of the electricity distribution customers, provides 98% of the electricity transmission capacity, and serves 99.8% of the natural gas distribution customers in the Province of Ontario.³
3. In this submission, the OEA is providing: (i) comments on the scope and substance of Issue #1 a, (ii) recommended changes to the other issues on the Draft Issues List, and (iii) submissions with respect to on the OEB’s plans regarding the release of confidential utility data.

¹ The Accounts are outlined in the OEB Letter March 25, 2020 Re: Accounting Order for the Establishment of Deferral Accounts to Record Impacts Arising from the COVID-19 Emergency

² OEB Letter May 14, 2020 Re: Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency, Page 4 “Ontario Energy Board File Number: EB-2020-0133 The OEB expects that the Utilities and groups representing the same interests or class of persons will make every effort to coordinate their participation in this consultation.”

³ Percentage contributions of CLD+ derived from 2018 OEB Yearbook

SUMMARY

4. The OEA strongly supports the OEB's proactive establishment of the Accounts and its other efforts to support customers and regulated entities during the COVID-19 emergency.
5. The OEA requests that as part of its early guidance, the OEB create an additional sub-account within the Accounts to record Bad Debt separately from Other Costs.⁴
 - a) The OEA requests that when it publishes the finalized Issues List, the OEB also set out all of the remaining steps and timeline for this policy proceeding.
 - b) The OEA requests the OEB expedite the policy proceeding, consistent with its previously expressed intention, and the feedback received from numerous utility and non-utility stakeholders during the May 28 stakeholder meeting. Until the OEB provides sufficient regulatory guidance, there is a high degree of uncertainty with respect to the proper accounting for significant costs and lost revenues. Absent sufficient advanced OEB guidance, second quarter ("Q2") financial statements for utilities (as at June 30, 2020) will reflect that uncertainty.
 - c) The OEA requests that the OEB provide final regulatory guidance by completing this policy proceeding, at the latest, prior to when utilities finalize their Q3 financial statements (in the weeks following September 30, 2020). That regulatory guidance will inform how the Accounts operate in relation to industry-specific Accounting Standards Codification reference topic 980 ("ASC980").⁵

⁴ A potential naming for this fourth sub-account is: Account 1509 - Impacts Arising from the COVID-19 Emergency, Sub-account Bad Debt

⁵ ASC represents US GAAP 980 or Accounting Standards Codification which is the current single source of United States Generally Accepted Accounting Principles (GAAP) and is maintained by the Financial Accounting Standards Board (FASB)

- d) The OEA proposes that the references in the Draft Issues List to OPEB and Transition to IFRS consultations⁶ in Issue 2 be replaced with references to the Smart Meter and Recovery of Regulatory Assets (“Market Opening”) consultations⁷. Similar to the COVID-19 emergency situation, the proposed examples are driven by public policy imperatives, whereas the current references in Issue 2 were externally-driven changes to accounting rules.
- e) The OEA submits that Issue #5 should be removed from the Issues List. Appropriate benchmarking requires comparable data with sufficiently large sampling, which does not exist. The COVID-19 emergency is not a repeatable and measurable activity (i.e. one which could be deemed “industry norms”). The development of benchmarking is time-consuming and thus not aligned with the time-sensitive nature of the guidance required in this consultation.
- f) The OEA proposes that the OEB replace Issue #16 (b) with the following wording: “What factors in addition to those already outlined in the OEB guidelines for electricity and natural gas distributors,⁸ and any public policy imperatives, should the OEB take into consideration in considering any cost sharing?”
- g) The OEA proposes that the OEB add as an Issue: “What is the appropriate way to dispose of each subaccount? What rate design, cost allocation, and disposition timelines elements should be adopted?”
- h) The OEA requests the OEB reconsider its plans to publish data broken down by utility as outlined in its letter dated June 4, 2020. Given the limited regulatory guidance currently in place, the data entries by the utilities will necessarily be

⁶ Footnote cited for Issue #2: “For example, EB-2015-0040, Report of the Ontario Energy Board Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs, September 14, 2017, page 3; EB-2008-0408, Report of the Board Transition to International Financial Reporting Standards, July 28, 2009, Appendix 2: Summary of Board Policy”

⁷ Two references citing the Smart Meter and Market Opening consultations: G-2011-0001 Guideline Smart Meter Funding and Cost Recovery – Final Disposition, December 15, 2011, OEB Letter Jan 15, 2004 Re: Filing Guidelines: Applications for the Recovery of Regulatory Assets for April 1, 2004 Distribution Rate Adjustments

⁸ IBID

disparate and lack common meaning. Publishing that data at this stage will likely create confusion in this proceeding.

- i) With respect to all other Issues in the Draft Issues List, the OEA submits that the List is complete and the wording is appropriate.

6. The OEA's detailed submissions follow.

SUBMISSIONS

Issue #1

a: Should the OEB provide advanced policy direction in the near term (for example at the time of establishing the Final Issues list), to provide greater certainty with respect to the recoverability of amounts tracked in the Account, such as by confirming the recoverability of any incremental bad debt expense?

- 7. The OEB requested comments from stakeholders on three specific questions under Issue #1 a in its letter dated June 4, 2020.

Question 1: Any proposed changes to the wording of Issue #1 a.

- 8. The OEA accepts the current wording of Issue #1 a.

Question 2: Whether there is a need to provide advanced policy direction in the near term, to provide greater certainty with respect to the recoverability of amounts tracked in the Account to address immediate needs. Utilities should provide specific details of the necessity for advanced policy direction such as, for example, the need for recognition of the Account as a regulatory asset on the financial statements, or the need to support borrowing from lenders.

- 9. In establishing the Accounts, the OEB expressed two key objectives: 1) to provide the Utilities with the ability to record the financial impact of the COVID-19 emergency⁹ and 2) to provide visibility and tracking of the impact of COVID-19 on each of the Utilities.¹⁰

⁹ OEB Letter March 25, 2020

¹⁰ OEB Letter May 12, 2020

10. Based on the regulatory guidance to date, the Utilities cannot record the financial impact of the COVID-19 emergency with precision or certainty. One of the consequences of the imprecision and uncertainty is current balances do not provide meaningful visibility into the impact of COVID-19 on the Utilities.
11. The OEB may be able to further the objectives for the Accounts through advanced policy direction, and an expedient proceeding that prevents the Utilities and their customers from experiencing undue harm as a result of the COVID-19 emergency.
12. The OEA requests the OEB set out all of the steps and timelines for its issuance of final guidelines from this consultation at the same time it issues the finalized Issues List. The OEA submits that this consultation should be completed as soon as possible to allow the Utilities to expeditiously implement the OEB's regulatory guidance in their financial reporting, and use that certainty to inform business decisions. Those decisions include choices with respect to capital and operations spending amid the ongoing COVID-19 emergency.
13. The next financial reporting milestone for the Utilities are Q2 financial reports, which are prepared in the weeks following June 30, 2020. To the extent there is any further regulatory guidance with respect to the Accounts that the OEB can provide by then, the OEA respectfully requests that the OEB do so.
14. Recognizing the challenges of advance policy guidance in the current context, most Issues may not be resolvable until the conclusion of this proceeding. In that case, the OEA requests the OEB set a date for it issuing its final guidance in advance of the finalizing of the Utilities Q3 financial statements (in the weeks following September 30, 2020).
15. OEB staff indicated that it intends to provide final guidance by October/November 2020. The OEA submits that the earliest end of this timeline best reflects the urgency with which regulatory guidance is required. That guidance is necessary for the Utilities to understand the scope of the financial challenge that they must manage.

16. The OEA's analysis of the current wording in the OEB's Accounting Orders, lacks the needed clarity on the nature of the amounts that can be recorded, or the recoverability of the amounts recorded, both of which are required in order to recognize regulatory assets in accordance with accounting standards. While the current regulatory guidance does not allow the Accounts to be recorded as regulatory assets, once the regulatory guidance is finalized, that status may change. Pending finalized regulatory guidance, the impact to financial statements cannot be determined and therefore the Utilities are operating with very high degrees of financial uncertainty, which adversely affects business decision-making.
17. The OEA anticipates that the OEB may not be in a position to provide sufficient certainty through early guidance for the majority of identified incremental costs and all lost revenues. The OEA expects that the final regulatory guidance will provide the clarity that the Utilities require to appropriately record amounts in the Accounts, and thus fully understand the financial impact that must be managed.
18. The OEA undertook a comparison of the Accounting Order and the OEB guidance to date in relation to ASC980, which is the industry-specific accounting guidance for regulated operations. As context, the OEA's assessment is based on an understanding that the accounting frameworks adopted by the CLD+ rate-regulated utilities in Ontario are: a) US GAAP, b) IFRS, including IFRS 14 Regulatory Deferred Accounts, and c) IFRS, excluding IFRS 14 Regulatory Deferred Accounts.
19. Appendix A to this submission provides more detail regarding the OEA's assessment of the Accounting Order, in relation to the accounting standard. Examples of the greater detail that may be required to provide the certainty necessary for cost deferral and revenue recognition include:
- a. The scope of eligibility of costs for recovery from ratepayers;
 - b. Any methodologies, baselines or offsets that would be used;
 - c. Materiality thresholds;
 - d. The scope of cost-sharing that would apply, if any; and
 - e. The timing and mechanism for disposition.

20. Due to the need for specificity as outlined above and provided in Appendix A, the OEA submits that the OEB focus on ensuring an accelerated process is established as soon as possible so that the Utilities can use the guidance from this consultation to appropriately reflect the impacts of the COVID emergency on their financial statements.

21. In addition to the request for the OEB to consider the acceleration of the consultation timeline, the OEA requests the OEB create a separate Bad Debt sub-account. The OEA expects that the issue of increased Bad Debt has unique characteristics with respect causality, materiality, and prudence. The OEA also expects that this will be one of the largest incremental costs for distributors arising from COVID-19.

Question 3: If so, what advanced policy direction should the OEB provide, and when?

22. The OEA proposes the OEB set out the procedural steps for an accelerated consultation timeline, so that the final regulatory guidance can be issued as soon as possible.

23. The OEA proposes that the OEB create the separate sub-account for Bad Debt immediately. Just as the OEB created the original three sub-accounts without a proceeding, separating Bad Debt from Other Costs can be separated without further consultation. The regulatory treatment of Bad Debt will remain a live issue during this policy proceeding.

Requested Changes to Draft Issues List: Issues 2- 17

Issue #2

To what extent can the regulatory principles identified in previous OEB consultations be of assistance in considering matters relating to the recording and disposition of the Account?¹¹

¹¹For example, EB-2015-0040, Report of the Ontario Energy Board Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs, September 14, 2017, page 3; EB-2008-0408, Report of the Board Transition to International Financial Reporting Standards, July 28, 2009, Appendix 2: Summary of Board Policy

24. The OEA's observation is that Issue #2 reflects the OEB's intent and wish to utilize the principles from prior consultations as guidance in this proceeding. The selection of principles is an important aspect to any consultation. Principles establish the points of focus, boundaries of discussion and approach of the consultation. In this proceeding, it is important to select references that are akin to the COVID-19 emergency.
25. The OEA submits this consultation has been initiated as a result of a public policy imperative, the COVID-19 emergency. The principles from the Smart Meter consultation and Market Opening consultation are more representative of public policy imperatives than the principles from the Pension and OPEB's and Transition to IFRS consultations. The Smart Meter and Market Opening initiatives were broad in their scope, affected all Ontario electricity distributors, and were driven by the need to ensure the prudent financial impacts of operations to meet public policy imperatives were appropriately recovered from customers.
26. The Smart Meter Initiative commenced with the Government of Ontario enacting regulations under the *Electricity Act* and *Ontario Energy Board Act*¹² with respect to implementation of smart meters across the Province of Ontario. The Board undertook a regulatory process over several years that provided the electricity distributors detailed guidance on the types of costs, mechanisms to calculate recoverable costs and the method for disposition of these costs. This initiative in its breadth and scope is similar to today's COVID-19 emergency. Both are externally driven consultations where the Utilities have been mandated by Government of Ontario regulations to implement public policy imperative actions. The OPEB and IFRS consultations were not Government of Ontario initiated, nor as broad in their scope or their impact on the CLD+. Those consultations were focused on applying changes in external accounting rules, not responding to public policy imperatives.

¹² G-2011-0001 Guideline Smart Meter Funding and Cost Recovery – Final Disposition, December 15, 2011, Page 4

Issue #5

- a) Should the OEB compare the amounts recorded in the Account to industry norms (e.g. benchmarking with other utilities in Ontario and Canada)?
- b) If so, what reporting should be required by Utilities to facilitate comparisons?

27. The OEA submits that Issue #5 be removed from the issues list. Issue #5 asks if the OEB should benchmark amounts recorded in the account to “industry norms”. Good benchmarking requires comparable data with a sufficiently large sample size of actual results so that the benchmark can be validated to be meaningful. It is unclear how the OEB intends to establish an “industry norm” for an exceptional event such as the COVID-19 emergency and, for which, actual results will not be available for quite some time.
28. Within Ontario, the impacts of the pandemic are likely to vary widely for each regulated entity depending on the composition of their business (i.e. generator, transmitter, distributor), customer base, and nature of their service area. Outside of Ontario, the regulatory relief mechanisms established by other regulators have varying scope of eligibility and few other jurisdictions have the number of smaller utilities found in Ontario. COVID-19 has affected every jurisdiction in different ways, and government responses have also varied widely, which makes establishing appropriate comparators difficult. Policy frameworks and data sets are continuing to evolve in Ontario, and it is likely that this is the case around the world, introducing major barriers to reliable benchmarking. These circumstances do not lend themselves to meaningful comparisons.
29. The process of benchmarking, done well, is a time-consuming exercise. To engage in benchmarking at a time when the industry needs expediency and in an unusual circumstance where the determination of an appropriate benchmark will be based on insufficient evidence, introduces an unnecessary delay to the resolution of this matter. Instead, the OEA submits that the OEB should focus on establishing the appropriate types of costs or lost revenue eligible for recovery, and the criteria for their recovery.

Issue #16

(b) What factors should the OEB take into consideration in considering any cost sharing, such as the impact of the COVID-19 emergency on the broader Ontario business environment?

30. The OEA requests the OEB replace Issue #16 (b) with the following wording:

"What factors in addition to those already outlined in the OEB guidelines for electricity distributors, transmitters and natural gas distributors, and any public policy imperatives, should the OEB take into consideration in considering any cost sharing?"

31. The reworded Issue #16(b) addresses two main concerns the OEA has with the current wording; first it removes the reference to "broader Ontario business environment" which is not defined and is ambiguous, at best. Second, the OEA submits that the reworded issue connects the question of cost sharing back to already established OEB guidance, which is an important foundational consideration.

32. The OEA also observes that the effort to define the reference to "broader Ontario business environment" in of itself will take some time, which could be spent reviewing substantive issues that are required by the Utilities to start using the Accounts.

33. The OEA also submits that the revised wording which references electricity distributors, transmitters, and natural gas distributor guidelines and public policy imperatives brings focus to the consultation's evaluation of what cost sharing if any should be implemented. The COVID-19 emergency and measures implemented by Government Orders or Directives are a matter of public policy imperatives which deem the services of the Utilities essential. They include legislated direction on how the Utilities must manage customer disconnections and direction to implement both mandated and Distributor-initiated customer relief programs. The need to comply with these externally-driven measures is an important distinction from the Ontario business environment and a consideration for this consultation.

34. For all these reasons, the OEA requests the OEB accept its proposal for Issue #16(b).

Additional Issues to be Added to the Final Issues List

Issue to evaluate the most appropriate mechanism to dispose of each subaccount

35. The OEA proposes the following issue be added: “What is the appropriate way to dispose of each subaccount? What rate design, cost allocation, and disposition timelines elements should be adopted?”
36. Currently there is no issue that deals with the actual mechanism for rate recovery (e.g. rate design, disposition period, etc.) The OEA requests the OEB add an Issue which considers whether certain items recorded in the Account can be given more mechanistic treatment (e.g. costs arising from policy requirements to provide support to customers).
37. The OEA notes that while some of these mechanisms for review and disposition would appropriately be the same across all sub-accounts, there may also be differentiation. Accordingly, the OEA proposes that the Issues List facilitate the OEB considering different mechanisms in relation to each sub-account.
38. The inclusion of an Issue that evaluates the use of mechanistic or formulaic approaches to the treatment of items recorded in the Account can provide both focus and priority towards removing subjectivity when the Utilities seek disposition of balances.

Additional Matter for OEB Consideration

Posting of Account Balance Data

39. In its June 4, 2020 letter, the OEB states that it intends to release the June 2020 balances in the COVID-19 account broken down by electricity distributor. The OEB stated that: “The intent of providing any initial data that may be available leading up to the July stakeholder forum, is to allow stakeholders the opportunity to understand the magnitude of the impacts. It is anticipated that this will allow

stakeholders to have a fruitful discussion on the nature of the impacts, and the activities being undertaken by utilities to respond to the emergency that give rise to incremental costs, savings, offsetting amounts, or lost revenue.”

40. The OEA submits that the data provided by each utility, whether overall or by sub-account, is not disaggregated and therefore provides no clarity to stakeholders regarding the Utilities’ activities in response to the emergency. Furthermore, utilities are not likely to be recording information in a consistent manner given the lack of specific accounting guidance, as well as, the varying nature of the impacts on a utility-by-utility basis.
41. Therefore, given the reporting data will not reflect the totality of amounts which will be present after the OEB’s final guidance is issued, comparing balances on a utility-by-utility basis will yield inaccurate comparisons.
42. It is the OEA’s view that the June 2020 balances are likely to be an underestimation of the overall impact to the sector, given the lack of detailed regulatory and accounting guidance available and the need for sufficient time to elapse before overdue accounts can be considered bad debt. Providing data in this manner can lead stakeholders to inaccurate conclusions regarding the magnitude of the issue that utilities are managing which is not helpful for the purposes of this consultation.
43. The OEA submits that the OEB reconsider its plans to provide data broken down by electricity distributor or by utility. Instead, the OEB should consider specific data requests of the Utilities as part of the consultation or allow for the Utilities to raise the impacts they are experiencing, in order to seek greater clarity regarding the eligibility and methodology for recovery of the impacts.

Conclusion

44. The OEA appreciates the opportunity to provide comments to the OEB regarding these important policy consultations and looks forward to future opportunities for engagement on these issues.

Appendix A: Accounting and Financial Reporting Considerations

1. Summary

The OEA has prepared a summary of the accounting rules under International Financial Reporting Standards (“IFRS”) and United States generally accepted accounting principles (“US GAAP”) which are required to be considered by Ontario rate-regulated utilities in accounting for the orders and other guidance issued by the OEB in the rate-regulated utilities’ external financial statements.

For clarity, this summary does not address accounting with the regulatory reporting to the OEB which may or may not be in accordance with the applicable financial reporting framework (e.g. amounts may be included in a deferral account submitted to the OEB that are not recognized in the external financial statements).

Many rate-regulated utilities use IFRS as their applicable financial reporting framework for external financial reporting, and others use US GAAP. Both IFRS and US GAAP have specific accounting rules for rate-regulated businesses which are applicable to the accounting for the actions of regulators.

Rate-regulated utilities in North America reporting under US GAAP, 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 account for the economic effects of rate regulation in accordance with the guidance in US GAAP ASC 980 *Regulated Operations* as is explained below.

2. Relevant accounting guidance of ASC 980 (and FAS71)

Topic 980-340-25: Recognition of regulatory assets

25-1 Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

- a. *It is probable (as defined in [US GAAP Topic 450, Contingencies]) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.*
- b. *Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator’s intent clearly be to permit recovery of the previously incurred cost.*

A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

Topic 980-605-25: Recognition of Alternative Revenue Programs

25-1 Traditionally, regulated utilities whose rates are determined based on cost of service invoice their customers by applying approved base rates (designed to recover the utility’s allowable costs including a return on shareholders’ investment) to usage. Some regulators of

utilities have also authorized the use of additional, alternative revenue programs. The major alternative revenue programs currently used can generally be segregated into two categories, Type A and Type B.

25-2 Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the utility for demand-side management initiatives (for example, no-growth plans and similar conservation efforts). Type B programs provide for additional billings (incentive awards) if the utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service.

25-3 Both types of programs enable the utility to adjust rates in the future (usually as a surcharge applied to future billings) in response to past activities or completed events.

25-4 Once the specific events permitting billing of the additional revenues under Type A and Type B programs have been completed, the regulated utility shall recognize the additional revenues if all of the following conditions are met:

- a. The program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates. Verification of the adjustment to future rates by the regulator would not preclude the adjustment from being considered automatic.
- b. The amount of additional revenues for the period is objectively determinable and is probable of recovery.
- c. The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized.

A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

Topic 980-605-30: Initial Measurement of Alternative Revenue Programs

Revenue Collected Subject to Refund

30-1 In some cases, a regulated entity is permitted to bill requested rate increases before the regulator has ruled on the request.

30-2 When the revenue is originally recorded, the criteria in paragraph 450-20-25-2 shall determine whether a provision for estimated refunds shall be accrued as a loss contingency. The inability to make a reasonable estimate of the amount of the obligation at the time of sale because of significant uncertainty about possible claims precludes accrual and, if the range of possible loss is wide, may raise a question about whether revenue should be recognized. Similarly, if the range of possible refund is wide and the amount of the refund cannot be reasonably estimated, there may be a question about whether it would be misleading to recognize the provisional revenue increase as income.

EITF Issue 92-7 Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs

EITF 92-7 was necessitated by the fact that when originally drafted in 1982, FAS 71, *Accounting for Certain Types of Regulation*, did not anticipate alternative revenue programs (ARPs) and referenced incurred costs, not the accrual of revenue, in its definition of a regulatory asset. The issuance of the EITF in 1992 confirmed the industry practice at

that time of accruing revenue and recording regulatory assets related to under collected revenue requirements associated with these ARPs, if certain criteria are met. Although the criteria set forth in EITF 92-7 have been included to ASC 980-605-25, the background and transitional requirements have not been included and are stated below.

Traditionally, regulated utilities whose rates are determined based on cost of service invoice their customers by applying approved base rates (designed to recover the utility's allowable costs including a return on shareholders' investment) to usage. Some regulators of utilities have also authorized the use of additional, alternative revenue programs. The major alternative revenue programs currently used are addressed in this Issue; they can generally be segregated into two categories, Type A and Type B. Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the utility for demand-side management initiatives (for example, no-growth plans and similar conservation efforts). Type B programs provide for additional billings (incentive awards) if the utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service.

Both types of programs enable the utility to adjust rates in the future (usually as a surcharge applied to future billings) in response to past activities or completed events. Such adjustments can also result in refunds to customers (for example, if actual sales to ratepayers are higher than expected or if specified performance targets are not met).

This Issue addresses the accounting for the additional revenues to be billed in the future under these alternative revenue programs that are probable of recovery. In practice and in concept, there seems to be no need to address the accounting for credit balances (that is, amounts due customers) which also result. These credits are recognized as liabilities because such amounts are considered "refunds" of past revenues (that is, those occurring during the measurement period) that are accounted for as contingent liabilities that meet the conditions for accrual under Statement 5 or in accordance with paragraph 11 of Statement 71.

If, at the date of this consensus, the rate-regulated utility is operating under an approved alternative revenue program that does not meet the above conditions (ASC 980-605-25-1 to 4) and it has been recognizing revenues based on the program, it may continue to recognize revenue under the program if (1) the utility has filed a rate application to have the plan amended to meet the above conditions or it intends to do so as soon as practicable and (2) it is probable that the regulator will change the terms of the alternative revenue program to meet these conditions.

FAS 71 Accounting for the Effects of Certain Types of Regulation, Basis for Conclusions

Although the Basis for Conclusions of FAS 71 have not been included to ASC 980¹³, 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.

Relationship of Regulatory-Prescribed Accounting to Generally Accepted Accounting Principles

¹³ In the FASB's codification project, Basis of Conclusions from issued standards were not carried forward into the ASCs.

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. [Emphasis added]

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.

3. Accounting considerations with respect to the OEB Deferral Account

Rate-regulated utilities in Ontario expect to incur incremental costs and a reduction in revenues during the COVID-19 period. These entities expect to incur incremental costs related to bad debts and other costs associated with remote working conditions and other workforce costs to ensure system reliability and safety, and supply chain cost increases. The reduction in revenues are expected to mainly relate to the loss of load and the waived or lower late payment charges. These entities are expected to request recovery of these incremental costs and loss of revenues in the future in accordance with the disposition process to be announced by the OEB.

Industry-specific accounting guidance for regulated operations is predominantly codified as ASC 980. The purpose of ASC 980 is for financial reporting to reflect the economic effects of certain rate-regulated activities and actions taken by regulators that arise in the normal course of regulated operations. The basic premise of ASC 980 is that the actions of a regulator will impact the financial statements prepared for financial reporting purposes only if the action has an economic effect on the rate-regulated utility, and that

the action of the regulator meets the requirements for recognition or deferral under the ASC 980 standard.

In general, in order for the guidance of ASC 980 to be applicable, an entity must be subject to regulation that determines rates at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital (interest costs and a provision for earnings on shareholders' investment).

ASC 980 includes specific guidance related to accounting for the impact of two types of actions of a regulator.

- a. The first area of guidance relates to revenue programs which require accounting under ASC 980 that differs from the normal revenue recognition standards under the applicable accounting framework. Under ASC 980 these are termed Alternative Revenue Programs (“ARPs”)
- b. The second areas of guidance relates to criteria for capitalizing of costs as regulatory assets that would otherwise be expensed as incurred absent the order of the regulator. Similarly if current recovery is provided for costs that are expected to be incurred in the future, ASC 980 requires rate-regulated utilities to recognize those current receipts as regulatory liabilities.

Discussion of the accounting criteria considerations as related to the COVID-19 Deferral Account order and related guidance is discussed below.

Alternative Revenue Programs

As mentioned above, the accounting treatment of ARPs were originally issued under the EITF 92-7, which is currently codified in ASC 980-605-25 *Alternative Revenue Programs*.

ARPs are contracts between a rate-regulated utility and a regulator of utilities; not a contract between a rate-regulated utility and a customer. The ARP programs typically enable the rate-regulated utility to automatically adjust rates in the future (usually as a surcharge or reduction applied to future billings) in response to past activities, transactions, or completed events.

As ASC 980's guidance for regulatory accounting is primarily a cost deferral approach, it provides limited guidance on revenues and therefore accounting for revenues is generally based on the entity's relevant accounting framework's revenue guidance. Revenues generated from ARPs are not within the scope of ASC 606 *Revenue from contracts with customers* nor IFRS 15 *Revenue from contracts with customers* because ARPs represent contracts between rate-regulated utilities and their regulators, not customers. As mentioned above, the main guidance for where revenues are not required to follow the relevant framework is codified in Topic 980-605.

The accounting guidelines for recording revenue related to future customer billings under an ARP program as a regulatory asset are stricter than the accounting guidelines for recording incurred costs as a regulatory asset. ASC 980-605-25 provides guidance for ARPs that allow rate-regulated utilities to bill customers for certain incremental revenue amounts in future periods but are associated with prior activities.

5.1 Sub-account - Lost Revenues

The Sub-account *Lost Revenues* provides for the tracking of lost revenues related to the waiver or reduction of late payment charges. Rate-regulated utilities also view that the impact of loss of load relating to the impacts of COVID-19 may also be eligible for tracking with the lost Revenues Sub-account.

In order for the Lost Revenues Sub-account to be given accounting recognition in a rate-regulated utility's financial statements, the lost revenue provisions of the OEB's accounting order would need to meet the criteria for recognition as an ARP under ASC 980-605-25.

Topic 980-605-25 has a two-step approach.

Step 1

The first step is to determine whether the current OEB's accounting order related to lost revenues fits within the definition of a Type A or Type B ARP as defined in Topic 980-605-25-1 to 25-3.

"25-1 Traditionally, regulated utilities whose rates are determined based on cost of service invoice their customers by applying approved base rates (designed to recover the utility's allowable costs including a return on shareholders' investment) to usage. Some regulators of utilities have also authorized the use of additional, alternative revenue programs. The major alternative revenue programs currently used can generally be segregated into two categories, Type A and Type B.

25-2 Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the utility for demand-side management initiatives (for example, no-growth plans and similar conservation efforts). Type B programs provide for additional billings (incentive awards) if the utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service.

25-3 Both types of programs enable the utility to adjust rates in the future (usually as a surcharge applied to future billings) in response to past activities or completed events."

ASC 980-605-25-2 describes Type A and Type B programs and lists examples of each type. The programs that qualify for each type are intended to be incremental to the rate-regulated utility's base rates or a change to the pace of collection based on sales volume. These programs are not designed to be for the recovery of allowable costs including a return.

Qualifying ARPs should be additions to billings, which are not cost-driven (i.e., the program should not be a cost deferral and recovery mechanism or a cost tracker). In order to qualify as an ARP, the resulting billings should be driven by broad external factors, such as changes in customer behavior that leads to changes in the demand for the commodity (Type A program) or incentive awards that are incremental to cost recovery (Type B program).

Type A

Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the utility for demand-side management initiatives (for example, no-growth plans and similar conservation efforts). [25-2]

These are rate normalization plans that adjust billings for the effects of weather abnormalities, broad external factors, or to compensate the rate-regulated utility for

DSM initiatives. For example, a rate decoupling program that provides the rate-regulated utility with the right to a fixed amount of revenue for the year or a fixed amount per customer, irrespective of usage (or some variation), to address fluctuations in revenue due to weather or consumption.

Type B

Type B programs provide for additional billings (incentive awards) if the utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service. [25-2]

These are incentive programs that provide for additional billings (incentive awards) if the rate-regulated utility achieves certain objectives, such as reduction of costs, reaching specified milestones, or improving customer service.

Both types of programs enable rate-regulated utilities to adjust rates in the future (usually as a surcharge applied to future billings i.e. a rate rider) in response to past activities or completed events. These programs can reduce volatility in earnings (important to rate-regulated utilities and their investors) and rates (important to customers).

Programs that create incremental revenue for a rate-regulated utility and fall under a Type A or Type B program would qualify for accounting as an ARP, assuming the other criteria in paragraph 980-605-25-4 are met.

These conditions are not to be used as guidelines; rather, they set a high hurdle for recognizing revenue under an ARP, and all of these conditions must be met.

Step 2

This step analyzes the requirements in ASC 980-605-25-4, which provides guidance on when a rate-regulated utility may record revenues related to a Type A or Type B alternative revenue program.

“25-4 Once the specific events permitting billing of the additional revenues under Type A and Type B programs have been completed, the regulated utility shall recognize the additional revenues if all of the following conditions are met:

- a. The program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates. Verification of the adjustment to future rates by the regulator would not preclude the adjustment from being considered automatic.*
- b. The amount of additional revenues for the period is objectively determinable and is probable of recovery.*
- c. The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized.” [Emphasis added]*

The first criteria is outlined in the first sentence of paragraph 25-4, which states that “Once the specific events permitting billing of the additional revenues under Type A and Type B programs have been completed....”.

Once the entity establishes that the events permitting billing have been completed, it then assesses if the other three criteria in paragraph 25-4 have been met. These three criteria establish a high threshold to recognize revenue prior to billing and collecting amounts from customers.

Due to the specificity of the guidance, a program must comply with all of the criteria to permit revenue recognition. For example, recognition by a rate-regulated utility would be

precluded if it does not have a specific rate order providing for the automatic adjustment of rates. An assessment that it is probable the regulator will adopt an ARP based on historical practice would not be sufficient to support recognition as 25-4(a) requires a rate order that allows for automatic adjustment of future rates.

Similarly, a rate-regulated utility should assess the amount of revenue to be collected under a program and the collection period (must be less than 24 months) in concluding on the appropriateness of revenue recognition. The condition for recognition indicates that “revenues will be collected.” If there is any uncertainty about whether the amounts will be collected or the period of collection is not known, this criterion would not be met.

Lost Revenues – loss of Load

Step 1

As mentioned above, when analyzing whether a particular program meets the criteria to qualify as an ARP, a rate-regulated utility should first assess the program’s purpose.

The key issues in Step 1 are the following:

- Whether rate-regulated utilities in Ontario have an existing program to allow them to recover loss of load revenues?
- If not, whether the OEB’s accounting order is providing sufficient guidance to qualify as an ARP?
- Whether the loss of load revenues qualify as a Type A or Type B program?
- Whether the loss of load revenues is related to past activities or completed events?

A program permitting a rate-regulated utility to recover the lost revenues resulting from a loss of load would likely meet the definition of Type A program as the objective is to recover the loss of load revenues resulting from COVID-19, an external factor.

“Type A programs adjust billings for the effects of weather abnormalities or broad external factors...”

The loss of load revenues should be considered a “completed event” as it is a point in time revenue instead of over time.

However, rate-regulated utilities in Ontario currently do not have an existing program in place that allows them to recover lost revenues related to the loss of load. Furthermore, the OEB’s accounting order does not specifically address the loss of load. The loss of load will only be addressed by the OEB during the consultation on COVID-19. Historically, variations in load (positive or negative), are risks borne by the rate-regulated utilities rather than the customers, i.e. fluctuations in load based on weather.

The resolution of these issues will be determinant before a rate-regulated utility can recognize a regulatory asset for the loss of load revenues.

Step 2

The key issues in Step 2 are the following:

- Whether the specific events permitting billing of the additional revenues have been completed?

- Whether there is a program established by an OEB's order that allows for automatic adjustment of future rates?
- Whether the amount of additional revenues for the period is objectively determinable and is probable of recovery?
- Whether the additional revenues will be collected within 24 months following the end of the annual period in which they are recognized?

As mentioned in Step 1, it does not appear that the OEB's accounting order addresses the three criteria for recognition of revenue under an ARP and clarification or additional program specificity by the OEB during the consultation process on COVID-19 will be necessary to make a determination of the accounting.

The Sub-account for the loss of revenues is for tracking the loss of revenues associated with any actions taken by a rate-regulated utility to provide relief to customers. It should be noted that the loss of load is not related to "actions taken to provide relief". The only loss of revenues mentioned in the accounting order is related to the waiver or lower late penalty charges. As a result, the consultation will need to provide clarity as to whether the loss of load should be included in the Sub-account.

Considerations as it relates to the criteria noted in 25-4:

[25-4 (a)] - "The program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates."

Based on the above Draft Issues to be addressed during the consultation, it appears that the accounting order is not a rate order to recover the loss of load nor does it allow for an automatic adjustment of future rates as the OEB has not decided whether the loss of load will be recoverable.

[25-4 (b)] - "The amount of additional revenues for the period is objectively determinable and is probable of recovery."

The accounting order does not provide guidance as to how to determine the loss of load revenues and whether or how they should be tracked in the deferral Sub-account. For example there is no guidance as to how to adjust for the load impact of weather from COVID-19 load impacts.

Based on the above Draft Issues, assuming that the loss of load will be considered, the OEB has still to determine the criteria, measurements, and limitations of the quantum impact for loss of load as well as if and how much will be recovered in rates in future.

[25-4 (c)] - "The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized."

The accounting order does not provide the timing of the recovery of this Sub-account.

Lost Revenues - Waiver or lower late payment charges

Step 1

Do the waiver or lower late payment charges meet the criteria of an ARPs?
If not, do they meet the recognition criteria under ASC 606 or IFRS 15?

5.2 Sub-account – Other Incremental Costs

The guidance for the deferral of incurred costs is applicable to bad debt expenses and costs related to billing changes as well as to any other incremental costs. In evaluating whether an incurred cost is eligible for deferral as a regulatory asset, a rate-regulated utility should determine whether the cost is probable of being recovered through future revenue from rates that the OEB allows to be charged to customers.

The requirements for the recognition of a regulatory asset with respect to an incurred cost have a lower hurdle than the requirements for the ARPs. There is no requirement to have an automatic rate adjustment clause for the recognition of a regulatory asset.

Determining whether rate recovery of an incurred cost is probable is a matter of judgment and management should evaluate the preponderance and quality of all evidence available. Different forms of evidence will provide varying degrees of support for management's assertion that a regulatory asset is probable of recovery; not all forms of evidence will be sufficient in isolation or in combination to make such an assertion.

In order to recognize this Sub-account as a regulatory asset, the rate-regulated utility needs to meet the recognition criteria mentioned in 980-340-25-1.

“Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

- a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.*
- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.” [Emphasis added]*

The concepts of “reasonable assurance” and assessing if it “is probable” that future revenue will be provided are a higher threshold than “more likely than not”. While US GAAP and ASC 980 do not give a numerical measure of what is “probable”, it is generally considered to be in excess of 75% probability as an indication of the level of certainty needed.

Generally, an accounting order alone will not provide sufficient evidence to support the recognition of a regulatory asset. As mentioned in the Basis of Conclusions of FAS 71, the existence of a tracking account may not be sufficient to recognize the economic effect of an order.

“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.” [FAS 71.52, Basis of Conclusions]

The OEB has issued an accounting order to track Other Incremental Costs resulting from COVID-19, which states that *“The OEB has not yet made a determination on the nature of revenue or costs that will be recoverable.”* In order to determine if the accounting order and related guidance provides sufficient evidence in order to conclude that it is probable that the amounts will be recoverable and to objectively measure and record a regulatory asset, the OEB will need to provide sufficient additional clarity and information that the OEB intends that the amounts will be recoverable.

The best evidence for a regulatory asset is a rate order, but the timing of the regulatory process sometimes does not enable the rate-regulated utility to obtain one prior to issuing its financial statements. Establishing probability of recovery is more difficult absent a rate order, especially when evaluating unusual or nonrecurring costs such as the COVID-19 costs.

Rate-regulated utilities have to exercise caution when placing reliance on a regulator’s accounting orders for financial reporting. An accounting order that indicates the incremental costs may be tracked for consideration in a future rate case, with no assurance of recovery, does not provide sufficient evidence that future recovery is probable without additional supporting evidence.

An accounting order along with sufficient supporting evidence may provide adequate support for establishment of a regulatory asset if it supports that recovery of the specific cost in the future is probable.

Forms of other evidence that when assessed in aggregate may support the recognition of a regulatory asset include:

- Rate orders for similar incurred costs obtained in the past by the entity or another entity in the same jurisdiction
- Communication from the regulator that the costs will be separately recoverable in future rates and that outlines in sufficient detail the methodology for measuring such costs and how they will be included in rates in future
- Opinion from internal or external legal counsel supporting the recoverability

Other factors to be considered in assessing other evidence include the following:

- The regulatory principles and precedents established by law
- The political and regulatory environment in the jurisdiction (i.e., Ontario)
- The magnitude of the incurred costs to be recovered and the related impact on customers

- Whether customers or others may intervene in an attempt to deny recovery

Under guidance included in ASC 980-340-25-1, an incurred cost that does not meet the asset recognition criteria at the date the cost is incurred should still be recognized as a regulatory asset in future when it meets those criteria at a later date. Therefore, a lag in regulatory action will not preclude an entity from recognizing a regulatory asset in future periods.

Discussion of COVID-19 incremental costs sub-account

At the present time, rate-regulated utilities in Ontario have had to make accounting decisions with respect to whether a regulatory asset can be recorded to offset incremental costs related to COVID-19. The assessment has a direct impact on reported earnings by the rate-regulated utilities and is used by capital markets in evaluating the financial impact of the pandemic.

Rate-regulated utilities in Ontario have to consider whether the OEB's issued accounting order and related guidance and consultations provide sufficient evidence that recovery of the specific costs is probable.

Another important accounting issue is that the OEB has issued no guidance with respect to how to measure incremental costs. It is apparent that the consultations discussed earlier will be used by the OEB to formulate its future decisions, however at this time, there is no certainty on how it will evaluate each utility's incremental costs sub-account for future disposition.

The OEB's eligibility criteria to recover costs that are genuinely external to the regulatory regime and beyond the control of management and the Board are causation, materiality and prudence.

Based on the Draft Issues list, it appears that the OEB is still evaluating whether rate-regulated utilities will be allowed to fully recover the amount of the incremental costs related to COVID-19. As a result, absent more clear direction from the OEB, it may be difficult to support that COVID-19 related incremental costs are probable of recovery as outlined in the accounting guidance discussed earlier

4. Other accounting considerations

The following matters will need to be considered before recording a regulatory asset for any of the three Sub-accounts created by the OEB.

6.1 Initial measurement of the deferral accounts

Incurred costs – other incremental costs

Based on the Draft Issues List, the OEB is considering an interim disposition of the account 1509 before the deferral account is brought forward for review and disposition.

While the existence of a mechanism for interim disposition may be evidence of probable recovery in rates to support recognition of a regulatory asset, there needs to be sufficient evidence to support the amount to be ultimately recovered. In addition, even if a

regulatory asset is not recorded, the amounts recorded as revenue need to be measured properly if they are subject to future adjustment.

Before a rate-regulated utility can recognize the interim disposition of the other incremental costs as revenues, it will be important to determine whether a provision for estimated refund should be accrued.

In some cases, a regulated entity is permitted to bill requested rate increases before the regulator has ruled on the request.

When the revenue is originally recorded, the criteria in paragraph 450-20-25-2 shall determine whether a provision for estimated refunds shall be accrued as a loss contingency. The inability to make a reasonable estimate of the amount of the obligation at the time of sale because of significant uncertainty about possible claims precludes accrual and, if the range of possible loss is wide, may raise a question about whether revenue should be recognized. Similarly, if the range of possible refund is wide and the amount of the refund cannot be reasonably estimated, there may be a question about whether it would be misleading to recognize the provisional revenue increase as income. [ASC 980-605-30-1 and 30-2]

Alternative revenue programs – lost revenues

As there is a higher hurdle to recognize a regulatory asset for the ARPs, in the absence of a rate order, a rate-regulated utility may not be able to recognize the interim disposition as revenues.

6.2 Materiality

The OEB stated in its letter of April 29, 2020 that *it will assess any claimed costs and/or lost revenues associated with any of the established sub-accounts at the time these sub-accounts are requested for disposition, subject to established materiality thresholds.*

When recognizing the regulatory asset related to the account 1509 for financial reporting purposes, rate-regulated utilities will need to consider the materiality associated with the account 1509. Currently, it is unclear how the materiality will be determined and whether it will affect the quantum of the account 1509 that can be recovered in future rates.

6.3 Cost savings and offsetting sources of funds

When recognizing the regulatory asset related to the account 1509 for financial reporting purposes, rate-regulated utilities will also have to consider whether any cost savings and other sources of funds should be recorded in the deferral account.

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