International Financial Reporting Standards ("IFRS") Consultation (EB-2008-0408) Draft Issues List OPG's Comments—February 9, 2009

Summary:

The purpose of OPG's comments is to seek clarification of the scope of the consultation and certain of the issues identified in the draft issues list. OPG has also proposed a set of principles against which alternative ratemaking and accounting treatments can be assessed.

Section A: Scope

The draft issues list states that "This consultation examines the effects of the adoption of IFRS on regulatory accounting and rate making, to identify any necessary changes to the Board's filing and reporting requirements and rate setting methodologies. This consultation will not include a discussion of changes to filing requirements and rate setting methodologies that are not driven by the adoption of IFRS."

As per the Board's December 23, 2008 letter, OPG understands that this consultation is focused on gas and electricity distributors. To make the draft List of Issues consistent with this focus, OPG recommends the flowing change to Section A (changes in **bold**):

"This consultation examines the effects of the adoption of IFRS on regulatory accounting and rate making, to identify any necessary changes to the Board's filing and reporting requirements and rate setting methodologies ***for natural gas and electricity distribution utilities."***

OPG further notes that that the scope says that the consultation will "not include a discussion of changes to filing requirements and rate setting methodologies that are not driven by the adoption of IFRS." OPG notes that KPMG's comments submitted October 29, 2008 states that "some standards that are equivalent (or substantively equivalent) to IFRS have already been adopted under Canadian GAAP. We note, by way of example, the following: Section 3031 *(Inventories)* which became effective from January 1, 2008 and Section 3064 *(Goodwill and Intangible Assets)* which became effective October 1, 2008. Further, changes to Section 3465 *(Income taxes)* relating to future income taxes for rate-regulated enterprises will become effective from January 1, 2009. KPMG recommended that "In particular, the effect of these "early" changes should be acknowledged in the Board's IFRS Transition Work Plan."

OPG expects that the OEB has already been faced with these issues is setting natural gas distribution rates effective January 1, 2008 and 2009, and in setting electricity distribution rates effective May 2008. If the Board has already addressed these issues in utility specific proceedings, then there is no need to include them in this generic review and they should be removed from the issues list.

If the OEB has addressed these issues in utility specific proceedings, OPG suggests the following change to Section A (changes in **bold**):

"This consultation will not include a discussion of changes to filing requirements and rate setting methodologies that are not driven by the adoption of IFRS ***or changes in Canadian GAAP prior to the implementation of IFRS."***

Section B: Principles

In determining the principles that should be applied to guide the implementation of IFRS, it is important to remember that the objectives behind *financial* accounting and *regulatory* accounting are different. The objective of financial accounting is to report on the financial performance/position of an entity at a particular point in time. The objective of regulatory accounting is to support the setting of just and reasonable rates; therefore the primary focus of regulatory accounting is cost recovery and rate making.

Since the primary focus of the OEB is rate setting, OPG submits that the objective of the regulatory accounting policies and methodologies established by the OEB should be consistent with that focus.

In general, OPG recommends that the Board apply the standard economic rate making principles that it applies when making any regulatory policy choice. There is nothing so unique about IFRS that should cause the Board to abandon these principles, namely the principles of fairness, stability, simplicity/understandability, etc. However, as the rate making objectives for various sectors of the energy industry are not the same, the application of standard economic rate making principles will not be the same. For instance, the regulatory objective of avoiding undue discrimination involves an application of the fairness principle that would not apply to a generation utility.

Some common economic rate making principles that OPG believes the Board should use to guide the implementation of IFRS for natural gas and distribution utilities include:

1) Fairness: A utility must be able to achieve the rate of return established by the regulator without causing undue harm to ratepayers. The regulatory compact is a concept rooted in farness: utilities recover costs incurred in good faith to provide customer service, while customers pay the reasonably incurred cost of the utility in providing that service.

2) Minimize Intergenerational Inequity: The cost of providing services should be matched to the period in which benefits are received from ratepayers. As timing differences are the main driver of differences between regulatory accounting and financial accounting (e.g. resulting in regulatory assets and liabilities) and IFRS directionally increases the potential for timing differences (versus Canadian GAAP), this principle is a fundamental consideration in developing regulatory accounting policies and practices

3) Stability: Mitigates rate shock to customers and reduces revenue volatility for utilities.

4) Predictability: Ratepayers can make informed decisions if they can predict future rates with reasonable precision. This encourages the efficient use of resources.

5) Simplicity/Understandability: Requires the balancing of regulatory burden associated with compliance with regulatory requirements with the need for sufficient information to establish just and reasonable rates.

6) Practicality/Materiality: To the extent the financial impact of differences between regulatory accounting and IFRS are not material (e.g. customer impacts are not undue and utilities are not unduly harmed), practicality would suggest a consistent approach to regulatory accounting and financial reporting.

7) Flexibility: The unique circumstances of a utility should be considered. Development of generic requirements should not create an undue burden of proof on an individual utility to demonstrate why the generic treatment should not apply. This principle is particularly germane to IFRS, as a number of issues will not be resolved prior to implementation (e.g. regulatory assets and liabilities, IFRS1 exemption from PPE restatement), while other issues were intended to implemented after the initial adoption of IFRS (e.g. revenue recognition).

Section C: Major Points of Departure between Existing Regulatory Accounting Rate Making and IFRS

OPG has two recommendations on Section C

OPG recommends that the OEB add a general statement to the issues list to the effect that "IFRS 1 considerations will be included in the discussion of the specific issues identified on the issues list."

It appears that Board staff intends to address IFRS 1 transition requirements on an issue-by-issue basis, as they are explicitly identified in the description of issue 3.1 (PPE). While implementation issues related to PPE are of great concern to many participants, there are significant implementation issues in other areas as well (e.g. Issue 5.1: pensions and employee future benefit costs) and the issues list should explicitly reflect this.

OPG notes that Asset Retirement Obligations ("AROs") has been added to the list of under Issue 3.4. As the Board is aware, AROs are a very significant issue for OPG. OPG's specific circumstances with respect to AROs are very different from those of distribution utilities.

OPG questions whether the issue is not too broadly framed. OPG notes that this issue was not included on the draft issues list, and was not raised at the January 27, 2009 meeting; therefore the description of the issue has not received the benefit of stakeholder input. It is recommended that the description of the issue be narrowed to only those issues of concern to LDCs. For example, if the primary concern of distributors is the IFRS requirement to recognize constructive obligations, the issue description could be revised accordingly. Board Staff may wish to discuss how this issue should be described with LDCs prior to submitting it to the Board.

Section D: External Uncertainties

Board staff advised participants in the IFRS public meetings that, in their view, the tax authorities were behind in their consideration of the implications of IFRS. OPG submits that the consultative would benefit from the perspective of the tax authorities in order to appropriately assess potential benefits from harmonizing regulatory accounting requirements with IFRS requirements, as any such benefits may be eliminated if the tax authorities require utilities to report for tax purposes on the basis of Canadian GAAP.

For example, if tax authorities require book values to be used in CCA calculations, changing regulatory accounting requirements to reflect fair market value for the purpose of harmonizing regulatory accounting with IFRS requirements will result in a new reconciliation between regulatory accounting and tax authority reporting requirements. It would therefore be premature for the Board to finalize its regulatory accounting and rate making methodologies absent an understanding of the reporting requirements of tax authorities.

As a result, OPG recommends adding to Section D an “Issue 6.2: Reporting Requirements of Tax Authorities”.