Richard P. Stephenson
T 416.646.4325 Asst 416.646.7417
F 416.646.4335
E richard.stephenson@paliareroland.com
www.paliareroland.com

File 17245

May 22, 2009

VIA EMAIL AND COURIER
VIA RESS FILING

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor, 2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Power Workers' Union Comments on the International Financial Reporting Standards Consultation
Board File No. EB-2008-0408

The Power Workers' Union ("PWU") represents a large portion of the employees working in Ontario's electricity industry and has the utmost interest in initiatives that impact the energy industry and the provision of ongoing service quality and reliability to customers. Attached please find a list of PWU employers.

The PWU is committed to participating in regulatory consultations and proceedings to contribute to the development of regulatory direction and policy that ensures ongoing service quality, reliability and safety at a reasonable price for Ontario customers. To this end, attached please find the PWU's comments on the International Financial Reporting Standards Consultation (EB-2008-0408).

We hope you will find the PWU's comments useful.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:jr
Doc 723239v1
cc:

John Sprackett, Power Workers' Union

List of PWU Employers

Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power – Lake Superior Power
Brookfield Power – Mississagi Power Trust
Bruce Power Inc.
Coor Nuclear Services
Corporation of the City of Dryden – Dryden Municipal Telephone
Corporation of the County of Brant, The
Coulter Water Meter Service Inc.
CRU Solutions Inc.
Ecaliber (Canada)
Electrical Safety Authority
EPCOR Calstock Power Plant
EPCOR Kapuskasing Power Plant
EPCOR Nipigon Power Plant
EPCOR Tunis Power Plant
Erie Thames Services and Powerlines
ES Fox
Great Lakes Power Limited
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kincardine Cable TV Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
London Hydro Corporation
Middlesex Power Distribution Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Safety Solutions
Nuclear Waste Management Organization
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Sioux Lookout Hydro Inc.
Sodexho Canada Ltd.
TransAlta Energy Corporation - O.H.S.C. Ottawa
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

EB-2008-0408

International Financial Reporting Standards ("IFRS") Consultation

Comments of the Power Workers' Union ("PWU")

I. BACKGROUND

In a letter dated December 23, 2008, the Ontario Energy Board ("OEB" or the "Board") launched a consultation to examine the issues associated with the transition to IFRS.

As required by the Canadian Accounting Standards Board, Canadian Generally Accepted Accounting Principles ("CGAAP") for publicly accountable enterprises will transition to IFRS, effective January 1, 2011. It is expected that most utilities regulated by the OEB will be required to adopt IFRS. The adoption of IFRS is expected to change the manner in which utilities execute their accounting and the reporting of financial results, and this may influence distribution rates or other charges.

On March 5, 2009 the Board released a report from its consultants KPMG entitled "KPMG Report to the Ontario Energy Board: Report on the Transition to International Financial Reporting Standards". The report provided analysis of the matters identified in the Issues List for the IFRS consultation, and highlighted the major potential impacts of the transition to IFRS from the perspectives of ratepayers, regulated utilities and the ratemaking process.

On April 24, 2009 Board Staff posted proposals ("Staff Proposal") for discussion based on the Issues List which was generated from discussions between Board Staff and consultation participants. The Staff Proposal was not approved by the Board but was intended to provide a starting point for discussions at the May 4-5, 2009 Technical Conference.

II. THE PWU'S POSITION

In general, the PWU supports the Staff Proposal. In the PWU's view the principles outlined in section B of the Staff Proposal reflects a balanced approach, in minimizing harm to both ratepayers and utilities to arrive at a regulatory accounting policy which will allow for the establishment of just and reasonable rates.

The positions taken by Board Staff on the Issues List in section C of the Staff Proposal are generally consistent with the aforementioned principles. The PWU therefore supports these positions on regulatory accounting and transitional issues, with the minor amendments proposed by the Electricity Distributors Association ("EDA").[1] Those proposed amendments are:

1. Any impacts on PILS paid by an LDC, directly resulting from the adoption of IFRS, should result in a true up of this change to a distributor's PILS revenue requirement until the next rebasing.

2. There should be no specified effective date for IFRS transition costs to become eligible for recovery.

3. A threshold test on transition costs may be established provided that:

   (a) the threshold level is consistent with typical IFRS implementation costs for LDCs;

   (b) costs below the threshold are recoverable without a discount; and

   (c) costs in excess of the threshold are subject to a full review by the Board

4. Transitional differences in the utility's revenue requirement during the IRM period due to the adoption of 'modified IFRS' for rate making purposes should be recorded in a deferral account for future disposition.

The PWU submits that each of these proposed amendments is consistent with sound rate-making principles, and that no evidence was introduced by any stakeholder opposing these proposals as appropriate amendments to the positions stated in the Staff Proposal.

III. AREAS WHERE EXISTING REGULATORY ACCOUNTING SHOULD BE RETAINED

Based on the presentations made at the Technical Conference held May 4 and 5, 2009 there appears to be a clear difference in the approach supported by ratepayer groups as opposed to that of utility representatives, on the principle of a 'default' accounting standard for regulatory purposes. Ratepayer groups support the maintenance of the status quo as the default accounting standard for regulatory purposes. Utilities support regulatory alignment with the IFRS requirements to the greatest extent possible.

Board Staff has stated that while the Board should continue to establish regulatory accounting requirements based on sound regulatory principles, it added that *Future regulatory accounting and regulatory reporting requirements established by the Board will be aligned with IFRS requirements as long as that alignment is not inconsistent with sound regulatory rate making principles*.[2]

There appears to be a consensus from all parties on two key issues where the status quo should be retained for regulatory purposes, even if it may differ from IFRS requirements:

1. the continuing need for deferral accounts for future cost recovery;[3] and
2. a rate base valued as at January 1, 2011 using the current regulated net book value of Property, Plant & Equipment ("PP&E") assets (rather than any different approach to asset valuation required under IFRS).[4]

---

[1] Transcript, May 5, 2009, pages 8-14

[2] Staff Proposal, Section B, Item 4

[3] *idem*, Section C, Item 2

The utilities' support for these positions reflect that although they favour regulatory alignment with IFRS requirements to a large extent, they recognize that certain exceptions are needed to ensure that sound regulatory rate making principles are maintained.

There are other notable issues on regulatory accounting treatment where the position stated in Section C of the Staff Proposal may deviate from IFRS requirements in order to achieve rate neutrality with existing Board policies, such as customer contributions received for PP&E (item 3.4), payments in lieu of corporate taxes (item 5.1) and pensions and future benefit costs (item 5.1). It is clear that the common understanding, in each of these cases, is that alignment with IFRS requirements would not necessarily result in a regulatory accounting policy which was consistent with sound rate-making principles, thus the Staff Proposal essentially maintains the existing regulatory treatment for these items, regardless of the manner in which the utility would be required to reflect them on their financial statements under IFRS.

IV. IMPACTS OF MISALIGNMENT BETWEEN IFRS AND REGULATORY ACCOUNTING

It was also clear from the comments of the utility representatives that the implementation of IFRS has wide-ranging impacts across a number of their business areas, beyond the accounting function. Changes in underlying core business practices at a transactional level, such as work order administration, will be required to capture the data essential to ensure compliance with IFRS requirements, as noted by both Hydro One Networks Inc. ("HONI")[5] and Toronto Hydro-Electric System Ltd. ("THESL").[6] To the extent regulatory accounting requirements do not align with IFRS, a separate set of records will be required for regulatory purposes, and a distinct audit of regulatory results will be required. A wide misalignment between financial and regulatory reporting requirements could thus result in a high degree of redundant data collection for each individual transaction.

---

[4] Staff Proposal, Section C, Item 3.1
[5] Transcript, May 4, 2009, pages 161-163
[6] Transcript, May 5, 2009, page 99

The PWU submits that a wider misalignment between reporting requirements would lead to a larger increase in the utilities' ongoing costs for operations and administration, which ratepayer groups have acknowledged should be recoverable from customers on the same basis as other costs. On the other hand, the adoption of an IFRS rule for regulatory purposes would lower the incremental cost of dual reporting requirements, and only affect the timing of cost recovery from ratepayers without increasing the total amount (in present dollar terms) to be collected over the longer term.

In addition to incremental ongoing costs for reporting purposes, a wider misalignment between financial and regulatory accounting would impose greater evidentiary burdens on cost of service rate applications. It can be expected that all parties would devote additional time and expense reviewing and challenging reconciliations and variance explanations dealing with differences in financial and regulatory reporting. Thus a higher number of differences between the two accounting frameworks would generally tend to increase the utility's costs, especially those associated with an application for rebased rates.

Another potential source of increase in the utilities' ongoing costs arises from the potential implications for their cost of capital. In defining the scope of this proceeding, the Staff Proposal states that the *consultation will not include a discussion of the financial risk profile of utilities, and how the adoption of IFRS may affect that risk profile.*[7] However, the PWU submits that the Board should consider how the degree of misalignment between IFRS and regulatory accounting may affect the perceived risk of the utility's business, and therefore their access to capital financing and the costs thereof. This issue was noted by both HONI[8] and Enbridge Gas Distribution Inc.[9]

It is well recognized that greater volatility in operating earnings (as shown on the utility's financial statements) generally results in a higher degree of perceived risk and thus the need for higher rates of return on investment. Again, this increased cost would be borne by ratepayers. This volatility is magnified when there is greater misalignment between financial and regulatory reporting requirements, since revenue is driven primarily by the latter while the former dictates the recognition of costs. This increase in perceived risk can arise even though the underlying economic condition of the utility would remain unchanged in the context of the existing (CGAAP-based) regulatory accounting framework.

The impact to the utilities' perceived risk, and consequently to their cost of capital, can be mitigated by supplemental disclosure in the notes to their financial statements, to demonstrate the degree of underlying stability in the entity's economic condition, notwithstanding the apparent volatility in its operating earnings. However, the PWU submits that a wider misalignment between financial and regulatory accounting would tend to limit the clarity of such disclosure, and thus its effectiveness in reducing perceived risk.

It is also important to note that most electricity distributors in Ontario are of such a size that they cannot efficiently access public financial markets; as a result they rely on their shareholder(s) and banks for debt financing. These utilities will generally not have the benefit of a debt rating agency or other independent analysts' assessments of their financial outlook, to inform investors more fully as to the stability of their economic condition.

Thus, for smaller and mid-size utilities, there is an even greater risk that extensive discontinuities between the recognition of revenues and costs in their financial reporting will lead to a higher overall cost of capital, and thus higher ongoing costs to be recovered from ratepayers. Furthermore, additional impediments to these utilities' access to capital could affect their capacity to carry out capital work programs which would be otherwise justified in an appropriate asset management plan. The result

---

[7] Staff Proposal, Section A
[8] Transcript, May 4, 2009, page 163
[9] Transcript, May 5, 2009, page 70

would be an impediment to capital investment that will negatively impact the utilities' ability to maintain ongoing service reliability, quality and safety.

V. OBJECTIONS TO ALIGNING REGULATORY ACCOUNTING WITH IFRS REQUIREMENTS

Notwithstanding the evidence that wider misalignment between IFRS and regulatory accounting would increase the utilities' ongoing costs, ratepayer groups generally support retaining the status quo as the default accounting for regulatory purposes. Counsel for the Industrial Gas Users Association stated that changes in accounting treatment arising from the adoption of IFRS should not result in any increase to a utility's revenue requirement.[10] Since the directional impact of any significant change in accounting treatment may vary according to each utility's particular circumstances, it generally follows that no uniform adoption of IFRS for any particular regulatory item could avoid an increase in the revenue requirement of a given utility, thus the CGAAP-based accounting would have to be retained indefinitely for regulatory purposes.

Mr. Browne, representing the 'Group of Eight' ratepayer groups, advocated an evaluation framework which should be applied to each difference in accounting treatment before the OEB approves any change in regulatory policy to align with IFRS. Similarly, Mr. Shepherd of the Schools Energy Coalition ("SEC") proposed a similar list of questions to be answered on each potential change in accounting treatment before IFRS could be adopted for regulatory purposes. In both cases, it was argued that the status quo, based on CGAAP, be retained as the basis for regulatory accounting until the evaluations could be completed.

The proposed evaluations cannot be completed at this time solely because the quantitative rate impacts of individual policy changes towards IFRS-based regulatory accounting cannot yet be ascertained. If this information were presently available, there would be no impediment to completing the proposed evaluations. However, it appears likely that there will be divergent impacts across various utilities given their differing circumstances.

VI. IRRELEVANCE OF SPECIFIC RATE IMPACTS FOR INDIVIDUAL ACCOUNTING CHANGES

The PWU submits that specific information on the rate impacts of individual accounting changes is not required to determine an appropriate basis for regulatory accounting, and that the Staff Proposal does in fact reflect a systematic application of appropriate evaluation criteria in determining a reasonable basis for regulatory accounting, consistent with sound rate making principles. In responding to a question from the PWU's representative, Mr. Shepherd agreed it was possible for a regulatory accounting rule based on IFRS to result in just and reasonable rates, even if such rates were materially different from those which would result from using the existing CGAAP-based rule:[11]

> **Mr. Cochrane: I am taking you back to your decision tree, under the box where you have the material impact on rates.[12] And I was just wondering if those two branches that follow from there are necessarily mutually exclusive, where the old rule could result in just and reasonable rates or a new rule could result in just and reasonable rates. Even if the rates are different, could they both not be arguably just and reasonable?**
>
> **Mr. Shepherd: I think in theory that is true. The concept of just and reasonable rates is sufficiently amorphous that you could have a situation where you could have a rate increase from one set of just and reasonable rates to another, particularly if you are looking at the context around it.**
>
> **So a change to increase cost X may be a reasonable change if you are also doing all of these other things that have countervailing impacts or complementary impacts. So I think you are right. I think it is not as simple as: It is either this or this […]**

Applying this logic, the rate impact of any single change in an accounting rule is not an essential element in determining an appropriate basis for regulatory accounting that would result in just and reasonable rates.

---

[10] Transcript, May 4, 2009, page 145
[11] Transcript, May 5, 2009, pages 143-144
[12] SEC Presentation, May 5, 2009, page 6 (top box: "IFRS rule/standard is different than CGAAP rule/standard")

It is sufficient, in the PWU's view, to examine the financial accounting rules themselves, without specific quantification of the impact of each rule change, to determine whether any given rule would be consistent with sound rate-making principles. It was on this basis that all parties agreed on the continued use of deferral accounts and the regulated net book value as at January 1, 2011 for rate base assets. It was clear that if IFRS would not necessarily permit such treatment on the utilities' financial statements, so the accounting of these items under IFRS could be inconsistent with sound rate making principles. No estimate of potential rate impacts was needed to arrive at this conclusion; it became apparent to all stakeholders, solely from examining the IFRS accounting rules, that those rules might be inconsistent with regulatory objectives and therefore the status quo should be retained in the regulatory accounting of these items.

VII. AREAS WHERE REGULATORY ACCOUNTING SHOULD BE ALIGNED WITH IFRS

The capitalization of overhead is an example of an issue where moving to IFRS as the basis for regulatory accounting may lead to a material change in rates. Based on a survey of utilities by Board Staff, the direction of the change is likely to vary by individual utility, and there is insufficient information to quantify the range of change impacts.[13] Yet the existing IFRS rules on capitalization are sufficiently clear for the Board to determine if they are consistent with sound rate-making principles.

Differences in rules on capitalizing overhead affect the timing, but not the total value (in present dollar terms) of a utility's cost recovery – the more overhead costs are capitalized, the greater the proportion of costs to be recovered in future periods as depreciation expense and return on capital. At present, capitalization policies under CGAAP vary across the industry. The same may be expected under IFRS, although likely to a lesser degree, given the more explicit definition of costs that can be capitalized under IFRS. There is no evidence to suggest that applying IFRS rules on overhead capilization for regulatory purposes would not result in just and reasonable rates, with the possible exception of training costs that must be expensed under IFRS. However, in most capital expenditures training costs would not constitute a major proportion of the new investment.

Other issues where the Staff Proposal recommends using IFRS as a default basis for regulatory accounting include:

- Depreciation of PP&E (subject to maintaining the straight-line method, and the use of existing methodology pending the completion of an appropriate depreciation study);
- Borrowing costs applied to PP&E (use of actual rather than deemed borrowing cost);
- Asset Retirement Obligations (subject to separate disclosure of amounts in rate filings for review by the Board); and
- Gains and Losses on disposition of assets (subject to separate disclosure of amounts in rate filings for review by the Board).

The PWU views these positions as reflecting a fair evaluation of relevant criteria to arrive at recommendations that are consistent with sound rate making principles. In the first two issues above, there is no evidence to suggest that alignment with IFRS requirements may not result in appropriate treatment for regulatory purposes. In the latter two issues, separate disclosure will allow the Board to determine the appropriate impact for rate setting purposes, according to the particular circumstances giving rise to the item in a utility's rate filing.

VIII. RELEVANCE OF OVERALL RATE IMPACTS

Of course, overall rate impacts must ultimately be considered in a comprehensive regulatory policy to ensure just and reasonable rates. The Staff Proposal addresses

---

[13] Transcript, May 4, 2009, pages 13-14

this issue by stating that upon rebasing, utilities will be required to quantify the revenue requirement differences arising from any changes in regulatory accounting treatment of specific items, and that rate mitigation mechanisms would apply in the event that the aggregate impact causes the 10% total bill increase threshold to be exceeded. For example, if in an atypical situation there was an unusually high component of training associated with a new capital investment, rate mitigation measures could be applied to compensate for the acceleration in cost recovery.

Given the recourse to rate mitigation measures to address bill impacts in excess of the 10% threshold, the PWU believes that the Staff Proposal on the regulatory accounting treatment under IFRS of various costs, as described in Part C sections 2 to 5 of the Staff Proposal, reflect positions which are consistent with sound rate-making principles while recognizing the significant advantages of maximizing alignment with IFRS requirements. Where IFRS accounting is consistent with regulatory objectives, such as in the case of overhead capitalization, the proposal supports alignment of regulatory accounting with IFRS. On those specific issues where it is not clear that alignment with IFRS requirements would be appropriate for regulatory purposes, the Board Staff position would result in rate neutrality with the status quo, or require separate disclosure for review by the Board in a rate filing.

IX. POLICY DETERMINATION FOR OPG

The PWU supports the position taken by Ontario Power Generation ("OPG") in its letter dated May 5, 2009. OPG stated that its unique circumstances, which differ significantly from those of distributors, should be considered specifically in a distinct proceeding prior to determining the impact of IFRS on its particular regulatory treatment. To date, the consultation's sole focus has been on the distribution sector, and has not constituted a forum for adequate consideration of applying the same standardized regulatory accounting rules to OPG.

The proposal of Board Staff recognizes as a principle that, although regulatory requirements should be uniform and standardized, *utility-specific issues can be* *addressed through a utility's applications.*[14] Following this principle, given the clear distinctiveness of OPG's business, the application of any or all IFRS requirements for regulatory purposes would be most appropriately considered in its next rates case. In determining how IFRS requirements will apply to OPG's regulatory treatment, the Board may be guided by some of its findings arising from this consultation. However, none of these findings should be applied automatically to OPG, until the Board has had an opportunity to consider the implications of the distinct nature of the regulated entity's circumstances, relative to that of distribution utilities.

All of which is respectfully submitted.