The Voice Of Ontario's Electricity Distributors

May 25, 2009

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

Via RESS and by courier

Dear Board Secretary:

Re: Board File No. EB-2008-0408
International Financial Reporting Standards (IFRS) – Implementation

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (LDCs). The EDA represents the interests of over 80 publicly and privately owned LDCs in Ontario. The EDA's comments on the Board staff proposals for implementation of IFRS are provided in the succeeding paragraphs.

'Fairness to customers' has been and always will remain the mainstay of LDCs' policies. LDCs have always embraced the principles of fairness, minimizing intergenerational inequity and minimizing rate volatility in formulating their own policies. The EDA scrutinized the Board staff proposals against these principles and determined that the staff proposals are generally sound and practicable.

The EDA also believes that if the system of regulatory accounting is aligned with that of financial accounting to the extent feasible, it will lead to minimization of differences between them and ultimately result in cost savings. Therefore, the EDA supports the principles as put forward by the Board staff.

In addition, the EDA generally concurs with the other proposals put forward by Board staff but recommends making four changes to those proposals. The staff proposals that require minor changes and the EDA's comments on a question which was not adequately addressed during the consultation process are discussed in the succeeding paragraphs.

1. <u>Accounting treatment for PILs</u>

The staff proposal suggests that LDCs will continue with the current practice of estimating taxes (PILs) and including them in the revenue requirement for rate setting purposes.

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Adoption of IFRS will potentially impact the PILs paid by utilities to the Government. However, the impacts will vary from utility to utility. For example, adopting Capitalization policies in accordance with IFRS may decrease the amount capitalized and increase the amount expensed on a yearly basis. This in turn will reduce the amount of PILs payable by LDCs compared to the amount currently recovered in existing rates. Therefore, the PILS component of the approved revenue requirement (the amount of PILs incorporated in rates) should be trued up similar to what occurs currently when statutory changes impacting PILs are introduced after the PILs revenue requirement has been established.

This truing-up will become necessary only for a brief period commencing with the IFRS implementation date until the next scheduled rebasing. At the time of rebasing, LDCs will incorporate into the revenue requirement the estimated taxes or PILs proxy that is expected based on IFRS.

The EDA therefore recommends that any impacts to PILS expenses directly resulting from the introduction of IFRS should result in a true up of the PILS revenue requirement similar to what occurs with statutory changes in PILS legislation.

2. Administrative costs related to transition to IFRS

The staff proposal suggests that LDCs may record the incremental administrative costs, incurred after January 1, 2009, related to transition to IFRS in a Board-approved deferral account for consideration by the Board at the next cost of service proceeding.

As long as the costs incurred are for the purpose of 'accounting transition' from the current framework of Canadian GAAP to IFRS, and those costs are subject to prudence review, there should be no limitation on the date when they were incurred such as 'after January 1, 2009'.

A number of LDCs incurred expenses prior to 2009 in making the transition to IFRS based accounting while the Board's consultation was in progress in 2008. In fact, the consultation on implementation of IFRS began as early as May 2008 and the EDA brought this issue to the Board's attention and requested the Board in October 2008 to establish a Deferral Account to record and track the incremental costs incurred in this connection. Therefore, we recommend removing the date limitation from the staff proposal.

3. Threshold test to encourage LDCs to minimize IFRS implementation costs

One staff proposal suggests establishing a threshold test similar to that used for 'Market Transition Costs' in order to encourage LDCs to minimize their IFRS implementation costs.

The EDA believes that a threshold, if any, should be set well in advance in order to serve the intended purpose of encouraging LDCs to minimize the transition costs. Setting a threshold after the fact (finish spending on transition) would not serve any purpose. In addition, the threshold level should be set such that most LDCs, acting reasonably, would be able to complete their transition to IFRS within that limit and without triggering a full prudence review process by the Board.

Further, if costs incurred by LDCs are below the threshold limit, full recovery of those costs should be permitted without applying a discount factor. And the costs in excess of the threshold limit should be eligible for recovery after a prudence review.

This would not only encourage LDCs to minimize transition costs but also would reduce regulatory burden on the Board. However, as the EDA is not aware of the total incremental costs that will be required for transition of accounting systems to IFRS, the EDA is not in a position to suggest a limit for that threshold at this time.

4. "Should any proposed increases in revenue requirement that may arise from changes in accounting for rate base and operating costs prompted by the adoption of modified IFRS be recovered from ratepayers? If yes, on what basis?"

The EDA believes that, once the modified IFRS is adopted for regulatory accounting, the recovery of increases in revenue requirement, if any, will only be a matter of a timing issue. For example, adopting capitalization policies in accordance with IFRS may decrease the amount capitalized and increase the amount expensed on a yearly basis. This will result in an increased revenue requirement but will reduce the capital costs that otherwise would have been recovered in rates.

Therefore, in accordance with the principle of maintaining fairness and minimizing intergenerational inequity, the increased revenue requirement should be recovered from rate payers on the same basis as other costs. During the IR plan term, the incremental revenue requirement arising from the adoption of IFRS should be recorded in a deferral account for future disposition. And at next rebasing, outstanding balances should be disposed of and permanent impacts are to be reflected in revenue requirements with appropriate implementation of rate mitigation plans where necessary.

Timing for Board's Decision

The EDA believes that the transition to IFRS will have a significant impact on LDCs' operations; systems and human resources. The impact will extend beyond the areas of rate setting, accounting policies and component accounting to encompass the operations of many departments in the distributor's organization.

From January 2010, LDCs will need to start collecting data under IFRS in order to be able to prepare financial statements under IFRS in 2011. Significant changes will be required at the transaction level to start collecting such data. The technological systems that LDCs currently use to record and analyze financial transactions will need to be modified. The systems must also be capable of capturing new information for required disclosures.

Another issue that is of particular significance to all the LDCs is the application of the components approach as required under IFRS. To apply the components approach appropriately, an in-depth analysis is required to identify the significant components that make up the respective capital asset pools. These components of capital assets under IFRS will have a useful life for amortization purposes that is separate from the broader asset group. The application of the components approach in the distribution industry may represent a very challenging task that requires a significant amount of resources and technical knowledge beyond that usually provided by the accounting group alone. The EDA supports the Board staff's initiative to facilitate an industry wide joint depreciation study and the EDA would be willing to assist the staff in completing the study.

In view of the above, the EDA believes that transitioning to IFRS will require a great deal of advanced planning, time and effort on the part of LDCs. There are a number of critical tasks that need to be completed prior to 2010 to ensure that when January 1, 2011 arrives, everything is in place to ensure a smooth transition. Therefore, it is important that the Board's decisions are available on all issues related to regulatory accounting as soon as possible.

Any delay in the Board's decision will cause undue strain to LDCs in implementing IFRS. In the absence of the Board's direction, LDCs will be compelled to make their own assumptions in their IFRS project planning processes in order to meet the IFRS implementation deadline. Thereafter, should the Board's direction require LDCs to change the decisions made based on earlier assumptions, the situation may lead to potential cost and time overruns for implementation of the project. Therefore, it is imperative that the Board's direction is made available to LDCs at the earliest possible date.

Yours truly,

"original signed"

Richard Zebrowski
Vice President, Policy and Corporate Affairs

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