IN THE MATTER OF the Ontario Energy Board's Consultation on International Financial Reporting Standards

SUBMISSION OF ONTARIO POWER GENERATION INC.

DATED MAY 25, 2009

Introduction

The OEB initiated a consultation on December 23, 2008 to examine issues associated with the transition to International Financial Reporting Standards ("IFRS"). Stakeholders were asked to provide their written comments by May 25, 2009.

OPG expressed concern with respect to the IFRS consultation process in an earlier letter to the OEB (dated May 5, 2009). In that letter, OPG requested that IFRS implementation for it be considered as part of OPG's next rates case. This will allow OPG's analysis and unique circumstances to be directly considered.

As noted previously (letter dated February 9, 2009), OPG has participated in the IFRS consultation process to understand the concerns of intervenors, the implementation issues faced by LDCs, and the views of the Board with respect to these LDC issues. This will assist OPG in implementing IFRS and in developing its regulatory accounting and ratemaking proposals for consideration at its next rates application, currently expected to occur in conjunction with the start of IFRS on January 1, 2011.

As OPG's analysis of IFRS is not complete, OPG's comments do not describe a "position"; rather these comments support the need to reflect a flexible approach to issues. Below, OPG provides comments on asset retirement obligations ("AROs"), payments in lieu of corporate income taxes, and pensions and employee future benefits costs

1) Asset Retirement Obligations (Issue 3.4):

<u>Board Staff Proposal:</u>
"IFRS requires that asset retirement obligations include estimates of the cost of certain obligations not required under existing accounting requirements, and revaluation of those obligations during the lives of the assets. For rate setting and reporting purposes, utilities shall identify separately the depreciation expense associated with amortizing the asset retirement cost and the accretion expense associated with the amortization of the asset retirement obligation. This will allow the Board to assess these costs independently of other amortization costs to determine the portion, if any, of these costs that should be recovered in revenue requirement." (Board Staff Proposal, page 4).

<u>Discussion:</u> KPMG was engaged by Board Staff to provide assistance on IFRS requirements and implementation issues. KPMG's presentation on May 4, 2009 highlighted that adoption of IFRS may result in the recognition of additional asset retirement obligations and that more frequent re-measurement may be required. This will lead to increased volatility in accretion expense, the portion of the Property, Plant and Equipment ("PPE") balance related to the ARO (i.e. the asset retirement cost) and therefore the related portion of depreciation expense. OPG agrees with this assessment.

Union Gas Limited ("Union") and Enbridge Gas Distribution Inc. ("Enbridge") also addressed the ARO issue on May 5, 2009 as described below.

Union recovers AROs in rates through depreciation. It noted that AROs increase the amount of negative salvage costs and therefore the amount collected through depreciation over the life of the asset. Union explained that it is uncertain whether some of the ARO costs currently reflected in its rates will qualify as constructive obligations under IFRS. The company proposed to continue using the group method of depreciation, recognizing the AROs in its depreciation expense. Including AROs in depreciation expense increases accumulated depreciation and therefore reduces the value of rate base. OPG views this method as a reasonable approach which reflects Union's unique circumstance. The regulatory accounting requirements developed for distributors should provide sufficient flexibility to accommodate Union's proposed approach.

Enbridge's situation appears to be more in line with the situation described by KPMG. Enbridge indicated that it anticipated an increase in its AROs as some of its obligations will become constructive obligations as defined under IFRS.

Enbridge noted that the Board Staff proposal was unclear with respect to ARO treatment in the context of negative salvage recovery in current depreciation rates. OPG shares this view. The Staff proposals in Section 3.4 of the Discussion Paper were described during the consultation as being "necessary to preserve the continuity of rate base" upon transition to IFRS. If the intention of the Board Staff proposals were to maintain the values of the components of rate base, then affected utilities will need to track any differences between the current rate base amount and the amount resulting from the valuation and composition of AROs determined pursuant to IFRS. It would be preferable if the Board accepted the use of a regulatory asset (in the case of Enbridge, for example) or liability (in the case of Union, for example) to capture the impact of differences between the current regulatory methodology and IFRS, thereby substantially reducing the reconciliation burden between financial and regulatory accounting records.

The AROs of Union and Enbridge appear to be different from each other and from those of OPG. For example, the impact of negative salvage was mentioned by both Union and Enbridge; however this is not an issue for OPG. Many of the issues OPG is required to address with respect to its substantial and unique AROs are not expected to affect other utilities; therefore the regulatory accounting approach should be sufficiently flexible to accommodate these differences.

OPG submits that the regulatory treatment of its ARO under IFRS should be addressed in OPG's next payment amounts application. OPG requests that that the Board specifically exempts it from the ARO requirements that will be applied to electricity distribution utilities.

2) Payments In Lieu of Corporate Income Taxes (Issue 5.1):

Board Staff Proposal:
"For electrical utilities, the Board will continue with the current practice of using estimated taxes (the tax or PILs proxy) to be included in the revenue requirement for rate-setting purposes.

For gas utilities, the Board will continue with the current practice for the inclusion of an estimated tax recovery in rates.

Tax or PILs related costs as incurred in the future might be recovered in rates when approved in a future rate proceeding." (Board Staff Proposal, page 6).

Discussion: Most, if not all, utilities will record future income taxes for financial reporting. The OEB does not currently accept the recovery of future income taxes in utility rates. Board Staff proposes to continue this treatment. This proposed ratemaking treatment was not contested during the consultation process; however the EDA noted that some IFRS implementation issues might impact the calculation of the income tax provision. The EDA proposed a regulatory asset or liability account to address this issue, which OPG submits is a reasonable approach.

Under Canadian GAAP guidance effective January 1, 2009, regulated entities that are on a “flow-through” method of recovery of income taxes are required to record future income tax assets and liabilities on their balance sheets, just like unregulated entities. Canadian GAAP enables regulated entities to establish an offsetting regulatory liability/asset for the future income tax asset/liability on the assumption that future income taxes will be recovered through rates. As a result, there is no income statement impact.

Union’s presentation noted that past practice implied that future income taxes would be recoverable; therefore it intended to record a regulatory asset or liability to offset the future income tax amount recorded in its financial statements. Union explained that the regulatory asset or liability account balance would automatically reverse itself over time as the future income taxes become current taxes.

Enbridge recommended that the OEB’s regulatory accounting system “require specific approval of a regulatory future income tax deferral account to enable recognition on a basis consistent with other deferral / variance accounts under IFRS.”

OPG submits that the Board’s regulatory accounting requirements for distributors should provide for the use of a regulatory asset or liability to offset the future income tax amounts that will be recoverable in future rates. The accounting requirements should provide an account description that clarifies that the Board will allow recovery of these regulatory assets or liabilities in future rates.

IFRS is not expected to provide for the recognition of an offsetting regulatory liability/asset for future income taxes as currently provided under Canadian GAAP. As a result, utilities will have to meet a potentially higher generic IASB threshold to be able to establish offsetting regulatory assets or liabilities for financial reporting purposes. Future income taxes are expected to be an issue for most utilities regulated by the OEB. This issue, if not appropriately addressed, can have a significant detrimental impact on the financial statements of utilities.

The auditors of some utilities may require a specific decision from the Board on the quantum of the future income tax authorized for recovery. OPG submits that the filing guidelines for distribution utilities should state that the Board will address the recoverability of future income tax amounts pursuant to an application by the utility.

OPG submits that the above proposals would provide utilities and their auditors with sufficient assurance of recoverability to enable utilities to recognize the regulatory asset or liability for financial reporting purposes.

3) Pensions and Employee Future Benefit Costs (Issue 5.1):

Board Staff Proposal:
"For gas utilities, the Board will continue to review pensions and employee future benefit costs in the utilities' rate applications.

For electrical utilities, the current practice approved by the Board will continue for pensions and employee future benefit costs. Any changes to current practice may be sought through an application to the Board." (Board Staff Proposal, page 6).

Discussion: In its presentation on May 4th, KPMG highlighted the key differences with the implementation of IFRS for utilities with defined benefit plans. These implementation issues are not relevant to the vast majority of utilities regulated by the OEB.

Union is one utility that is affected. During its presentation, Union indicated that it intends to write-off unamortized actuarial losses, unamortized past service costs and the unamortized transitional obligation through retained earnings on transition to IFRS. It noted that this treatment would reduce future expenses reported using IFRS. Union proposed to recover the amount written-off as this approach leaves both the ratepayer and the shareholder unaffected. Absent IFRS, these gains or losses would be included in pension expense in subsequent periods, and would therefore be recovered from ratepayers.

Union stated that the amount could either be included in rates immediately, or a regulatory asset could be established in the regulatory accounting system to provide for the recovery over time. OPG submits that the regulatory accounting requirements should provide for the recovery of a regulatory asset or liability account for distribution utilities with defined benefit plans. OPG proposes that the recovery period for this account should be established in a utility rate application where the specific circumstances of that utility can be directly considered.