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toronto hydro
electric system

May 25, 2009

via RESS and regular mail

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

Dear Ms. Walli:

RE: **EB-2008-0408 Consultation on Transition to International Financial Reporting Standards and Consequent Amendments to Regulatory Instruments**

Please see attached the submissions of Toronto Hydro-Electric System Limited.

Yours truly,

[Original signed by]

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:CJM/acc

EB-2008-0408

Consultation on Transition to International Financial Reporting Standards and Consequent Amendments to Regulatory Instruments

Toronto Hydro (THESL) Reponses to Board Staff Position Paper

Introduction

Board Staff has submitted its proposals with respect to each issue identified in the EB-2008-0408 IFRS consultation. For ease of reference, THESL has reproduced the Staff Position Paper with the comments of Toronto Hydro set out below in each section under the heading "*THESL RESPONSE*".

A. Scope

This consultation examines the effects of the adoption of International Financial Reporting Standards ("IFRS") on regulatory accounting and rate making, to identify necessary changes to the Board's filing and reporting requirements and rate setting methodologies. It includes changes in Canadian GAAP related to the implementation of IFRS. 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.

This consultation will not include a discussion of the financial risk profile of utilities, and how the adoption of IFRS may affect that risk profile.

THESL RESPONSE:

THESL accepts this proposition.

B. Principles

1.1 In considering the issues listed below, what principles should the Board use to guide the determination of the preferred alternative? Examples of key questions:

- How much difference between IFRS and regulatory accounting is sustainable in the long term?
- To what degree should avoidance of harm to ratepayers prevail over other considerations?
- To what degree should avoidance of harm to utilities prevail over other considerations?

1. The methodologies used by the Board to establish just and reasonable rates have not always been the same as those used for external financial reporting purposes. The Board has and will retain the authority to establish regulatory accounting and regulatory reporting requirements. IFRS accounting requirements will not be the sole driver of regulatory requirements.

2. Future regulatory accounting and regulatory reporting requirements established by the Board will continue to be based on sound regulatory principles. These principles include fairness, minimizing intergenerational inequity and minimizing rate volatility.

3. Future regulatory accounting and regulatory reporting requirements established by the Board will, in taking into account IFRS requirements, balance the effects on both customers and shareholders.

4. 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.

5. Future regulatory accounting and regulatory reporting requirements established by the Board will be universal and standardized for all utilities, while recognizing that utility-specific issues can be addressed through a utility's applications.

THESL RESPONSE:

THESL accepts Staff Propositions 1 and 5 and endorses Propositions 2, 3, and 4. The overall impacts (i.e., costs and other changes) of transitioning to IFRS should be minimized to the extent possible consistent with the requirements of *ratemaking, and those impacts should be fairly distributed between utilities and ratepayers.*

C. Major points of departure between existing regulatory accounting and rate making as compared to IFRS

2. Regulatory Assets and Liabilities

2.1 Should the Board continue to use deferral and variance accounts in the event that they are not recognized under IFRS?

The Board will continue to use deferral and variance accounts for rate making in appropriate circumstances, whether or not these accounts are recognized under IFRS.

THESL RESPONSE:

THESL takes the view that the judicious use of deferral and variance accounts within the current regulatory construct is indispensible and should be continued independently of the adoption of IFRS. THESL observes however that if deferral and variance accounts are not recognized under IFRS, utilities will need expedited (i.e., within fiscal year) clearance of these accounts

2.2 Should the Board approve definitions for deferral and variance accounts if the Board retains their use for regulatory purposes?

The Board will retain the use of deferral and variance accounts for regulatory purposes. At this time, the Board will continue to apply the existing approach in the use and establishment of such accounts. The Board may consider the review and adjustment of its existing approach when the rulings from the International Accounting Standards Board are received and the interpretation of IFRS becomes clearer.

THESL RESPONSE:

THESL agrees that the Board should review and make adjustments, if applicable, to its existing approach if the International Accounting Standards Board (IASB) makes a ruling on accounting for rate-regulated operations. This will assist utilities in ensuring that the recognition criteria for regulatory assets and liabilities under IFRS are met should such a new standard be approved.

Utilities may use appropriate financial reporting methods to increase the understanding of the nature of deferral and variance accounts within the

financial community, such as increased disclosure in the notes to audited financial statements, increased management discussion and analysis (MD&A) in annual reports, and the education of financial professionals.

THESL RESPONSE:

THESL supports this suggestion but the Board should consider that the additional information disclosed in the notes to the financial statements is required to be audited. This will result in additional effort and audit costs should a standard for accounting for rate-regulated operations not be developed, since such assurance would not be provided within the scope of a financial statement audit under IFRS.

3. Property, Plant and Equipment

3.1 For the purpose of first-time adoption of IFRS, should the Board require historic cost (NBV) or the IFRS adoption requirements (fair value or retrospective restatement) to be used as the basis for setting opening rate base values and reporting to the Board?

The Board will require regulated net book value to be used as the basis for setting opening rate base values and reporting to the Board at the time of the first report to the Board or rate application for periods subsequent to the adoption of IFRS. To establish continuity of historic cost, the statement of opening value for regulated net book value includes providing gross capital cost and accumulated depreciation, subject to additional breakout of amounts as necessary to support regulatory accounting requirements stated in Section 3.4 below.

THESL RESPONSE:

THESL accepts the need to maintain continuity of historical ratebase and the reporting requirements that flow from that. However, THESL believes that the Board should recognize that mandating the use of regulated net book value for ratebase may result in utilities being required to maintain two separate books and records, for the following reasons:

- *On May 19, 2009 the IASB decided to defer its final decision on the rate-regulated IFRS 1 amendment so that it could be incorporated in the exposure draft expected for rate-regulated activities. This decision has now pushed out the timing of a final decision on this exemption until the rate-regulated standard is finalized, which is expected in June 2010. In addition the Board did decide to remove the impracticability criteria however indicated that utilities will be required to make some adjustments to the carrying historical cost so that it is more inline with IFRS. The*

> *extent of the required adjustments is unknown at this time and will not be finalized until the release of the rate-regulated standard.*

Given the above factors, some utilities will need to maintain two sets of books for the cost and associated depreciation of PP&E. Some large utilities will need to make significant modifications to their systems in order to record these transactional level details within both sets of books and records. The requirement for two sets of books and records increases the amount of one-time administrative cost to transition to IFRS-based reporting and increase ongoing administrative costs for IFRS and required regulatory reporting.

3.2 After adoption, what should be the basis for reporting PP&E for regulatory purposes (e.g. historical acquisition cost, fair value)?

The Board will require the use of historical acquisition cost as the basis for reporting PP&E for regulatory purposes.

THESL RESPONSE:

Subject to its comments above regarding the maintenance of two sets of books, THESL accepts the use of historical acquisition cost as the basis for reporting PP&E (i.e., historical ratebase and capital additions). Investments in utility plant and equipment are not made for the purpose of resale and neither ratepayers nor utilities should be at risk, for the purpose of ratemaking, for fluctuations in asset values.

3.3 Should the Board require PP&E to conform to IFRS capitalization requirements (e.g., capitalize less indirect overhead and administration cost)?

The Board will require utilities to adhere to IFRS capitalization accounting requirements for rate making and regulatory reporting purposes after the date of adoption of IFRS. The utility will file a copy of its capitalization policy, identifying any updates to the policy, as part of its first rate filing after IFRS adoption.

THESL RESPONSE:

THESL submits that the issue of capitalization of overheads should be determined fundamentally with reference to the standing regulatory principle of matching costs to benefits to ratepayers through time. The Staff proposition above assumes that IFRS requirements will lead to capitalizing less indirect overhead and administration costs, and provide a better match between costs *and benefits through time. Neither of these assumptions has been demonstrated generally or in the case of a particular utility, as would be required for ratesetting purposes.*

Nevertheless, THESL also accepts that matching costs and benefits through time is not a matter of mere observation and that significant judgement must be exercised in many instances. Furthermore, substantial benefits in the form of simplicity and consistency between utilities could be achieved if IFRS captilization requirements could be justified as producing a reasonable match of costs and benefits for ratesetting purposes.

THESL does not believe that this issue can be resolved at the level of practice until detailed determinations of "IFRS capitalization accounting requirements" are established. It is possible that auditing firms may take different views of whether costs in a specific category (e.g., training required for personnel to enter confined spaces) are properly capitalized under IFRS. In order to achieve consistency of treatment between utilities, the Board should consult with utilities and auditing firms to develop a detailed list of specific cost categories that should be included or excluded for capitalization for ratesetting purposes, and reflect these in a modified Accounting Procedures Handbook.

3.4 What changes to existing regulatory or rate making treatments should the Board require for other PP&E related items as a result of the adoption of IFRS?

- Borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC)
- Customer contributions received for PP&E
- Asset reclassifications from PPE to intangible assets (e.g., computer software and land rights).
- Asset retirement obligations
- Gains and losses on disposition of assets
- Treatment of asset impairment

The Board will require utilities to adhere to IFRS accounting requirements for items related to PP&E for rate application filings and for reporting to the Board after the date of adoption of IFRS, except where specifically noted below.

List of rate adjustments or prescribed treatments:

- ***Borrowing costs applied to CWIP: IFRS requires utilities to capitalize carrying charges associated with Construction Work in Progress (CWIP) using actual interest cost incurred as opposed to amounts calculated at rates prescribed by the regulator. On or before the date***

for adoption of IFRS, the Board will discontinue publication of market based rates for applying borrowing costs to CWIP. For regulatory rate making and reporting the Board will use the values calculated in accordance with IFRS to determine capitalized carrying charges on CWIP.

THESL RESPONSE:

THESL agrees that the Board should, for ratemaking and reporting purposes, allow for capitalized borrowing cost in accordance with IFRS.

- ***Customer contributions received for PP&E: IFRS requires customer contributions to be recorded as revenue or deferred revenue (depending on the circumstances) instead of as an offset to capital cost. For regulatory reporting and rate making purposes the amount of customer contributions will be treated as deferred revenue to be included as an offset to rate base and amortized to income over the life of the facility to which it relates. This reclassification is necessary to preserve continuity of the rate base.***

  THESL RESPONSE:

  THESL agrees with this difference in accounting from IFRS as it is required to preserve the continuity of the rate base. The Board should recognize the implications of this difference for utilities that receive many customer contributions, and which will need to record the capital cost offset at the transactional level to maintain accuracy and efficiencies in calculating the amount of depreciation. Further, the Board should consider that with recent the publication of IFRIC 18 Transfer of Assets from Customer on January 29, 2009, there are many interpretations of this new standard which may further support the requirement for two sets of books and records for PP&E.

  The Board should also consider the possible implications around the accounting for capital contributions paid out by utilities (i.e., THESL's capital contributions to Hydro One) and the differences that exist with IFRS and current Canadian GAAP. Therefore the definition of the rate base must be expanded to include these and other differences.

- ***Asset reclassifications from PP&E to intangible assets (e.g., computer software and land rights): IFRS requires certain assets to be recorded as intangible assets (e.g. computer software and land rights) that were previously included in PP&E. Utilities shall include such intangible assets in rate base and the amortization expense in***

depreciation expense for determining the revenue requirement. This reclassification is also necessary to preserve continuity of the rate base.

THESL has no further comments.

- ***Asset retirement obligations: 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.***

  THESL RESPONSE:

  THESL agrees that it is important that the Board review these costs separately as amounts will be incremental costs to the utilities and that these amounts should be recovered through revenue requirements. The Board should determine how it will review these costs (i.e., mechanism and frequency) and assess the timing of rate recovery.

- ***Gains and losses on disposition of assets: Where a utility for financial reporting purposes under IFRS has accounted for the amount of gain or loss on the retirement of assets in a pool of like assets as a charge or credit to income, for reporting and rate application filings the utility shall reclassify such gains and losses as depreciation expense and disclose the amount separately. Where a utility for financial reporting purposes under IFRS has reported a gain or loss on disposition of individual assets, such amounts should be identified separately in rate filings for review by the Board (as at present).***

  THESL RESPONSE:

  THESL accepts these propositions.

  However, since group depreciation is not acceptable under IFRS, asset derecognition will be required and gains and losses on disposition will be credited or charged to the P&L. When there is a large unbudgeted *derecognition under IFRS, the Board should consider the ability of utilities to recover these costs within revenue requirements. Under the current regulatory methodology utilities would continue to recoup these costs through depreciation until the asset was fully depreciated. However, under IFRS, when there is an unbudgeted derecognition, NBV will be removed from ratebase and the utility would not be able to claim the associated depreciation in revenue requirement. In these circumstances the Board should establish a variance account to ensure that depreciation costs are recouped.*

- ***Treatment of asset impairment: Where for financial reporting purposes under IFRS a utility has recorded an asset impairment loss, for rate application filings such losses shall be reclassified to PP&E and identified separately to allow consideration of whether and how such amounts are to be reflected in rates.***

  THESL RESPONSE:

  THESL agrees that any amounts of impairment should remain within the cost base of PP&E and that rate calculations should incorporate these amounts. This could be done using a variance account.

4. Depreciation

4.1 Should the Board set parameters for depreciation accounting for regulatory purposes (e.g. depreciation methods, the level at which sub-componentization should be applied to specified asset classes)?

Utilities should continue to use the straight line method of depreciation. As described in issue 4.2 below, the Board anticipates that a joint depreciation study will be conducted which results in depreciation methodologies and rates which are consistent with IFRS requirements.

THESL RESPONSE:

THESL supports the use of the straight line depreciation method and/or other depreciation methods as allowed by IFRS. For comments on the joint depreciation study, please refer to issue 4.2.

4.2 Should the Board set the parameters for electricity distributors to establish their own depreciation rates rather than continue to use depreciation rates historically provided by the Board (co-ordination of depreciation studies may be possible)?

The Board will facilitate a joint depreciation study for electrical distribution utilities. The aim of the study will be to determine depreciation methodologies and rates that will be applied to all electrical distribution utilities for the purpose of setting rates and regulatory reporting. The study must give due weight to the IFRS requirements regarding depreciation, including componentization. Until the study is completed and the resulting depreciation rates are modified or adopted by the Board, electrical utilities will continue to use their present depreciation rates.

Any electrical utility retains the option of demonstrating, through a well-founded depreciation study, that the Board should approve specific depreciation methodologies and rates for that utility.

THESL RESPONSE:

THESL supports a joint depreciation study for electrical distribution utilities and suggests that this study by completed prior to January 1, 2010 and that the resulting methodology be IFRS compliant as utilities will be required to maintain IFRS accounting records for comparative purposes beginning in 2010.

THESL also submits that larger utilities should have the option to conduct a separate depreciation study for their specific property, plant and equipment. Different utilities will maintain and use their assets differently from other utilities and as such this may result in different useful lives for the same kind of assets. Further, given the transactional differences that may exist between IFRS and modified IFRS, as defined by the Board, system changes and decisions need to be made now to ensure that these systems are converted for January 1, 2010, thus effectively supporting two sets of books and records.

The Board should also consider that utilities will need to complete componentization studies to ensure that assets are broken down into their components as required by IFRS (IAS 16) given that some utilities were following the group method of depreciation.

Gas utilities may submit a utility-specific depreciation study, which should include their proposed treatment of items unique to the gas industry (e.g., cushion gas).

THESL has no further comments.

5. Other Issues

5.1 What changes to existing regulatory accounting and rate treatments should the Board require for other items?

- Inventory valuation (based on lower of cost and net realizable value)

For gas utilities, the Board will continue the current practice of recording the difference between the actual purchase price of gas inventory and the weighted average cost of gas (forecast purchase price approved by the Board) in a variance account (PGVA) for future collection or refund to customers when approved by the Board.

THESL has no further comments.

- Payments in lieu of corporate income taxes

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.

However, the Board should consider that the accounting income resulting from the implementation of IFRS may impact taxable income and taxes payable. The extent of the impact on PILs to be included within the distribution rates will depend on each utility's specific accounting and tax positions.

THESL accepts this proposition.

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 may be recovered in rates when approved in a future rate proceeding.

THESL has no further comments.

- Pensions and employee future benefit costs

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.

THESL RESPONSE:

The Board will need to consider that IFRS 1 provides optional exemptions where entities can (1) elect to recognize all cumulative actuarial gains / losses in equity *at date of transition, and (2) select an accounting policy choice for recognition of actuarial gains / losses under IFRS (corridor method, immediately in equity or systematic method that results in faster recognition).*

Should a utility elect (1) above, these gains/losses will be taken through retained earnings on transition which will in turn increase/decrease future expenses. Where immediate recovery of transition impact is not appropriate, a deferral mechanism (regulatory asset) will be required to continue to recover the amortized costs in rates.

In relation to election (2) above, there is currently some activity within the IASB to potentially remove the corridor approach which is the method that allows for the most smoothing of pension expenses. Should this approach be removed it would accelerate expenses with the expected return on plan assets at fair value and given that this amount flows into rates, it may have an impact on capitalized amounts. Therefore, any changes to current THESL practice will be sought through an application to the Board

D. External Uncertainties

6. Decisions of Accounting Standard-Setting Bodies

6.1 What are the potential implications on the Board's decisions of the questions now before accounting standard-setting bodies? These uncertainties include:

- Potential exemption from the requirement for retrospective or fair value restatement of PP&E (International Accounting Standards Board)

The Board has determined its policy choice on issue 3.1 in the absence of a decision from the IASB.

THESL has no further comments.

- Recognition of regulatory assets and liabilities, e.g., deferral and variance accounts (International Accounting Standards Board)

The Board has determined its policy choice on issue 2.1 in the absence of a decision from the IASB.

THESL has no further comments.

- Whether accounting standards will require municipal and provincial government-owned distributors (government business enterprises) to adopt IFRS (Public Sector Accounting Board – Canada)

The Board is proceeding to set policy assuming that the utilities it regulates will be required to adopt IFRS for financial reporting purposes.

THESL has no further comments.

- Other developments from accounting standard-setting bodies

The Board is proceeding to set policy in the absence of any other developments from accounting standard-setting bodies.

THESL RESPONSE:

The Board should consider that other developments from accounting standard-setting bodies will occur and will have an impact on the accounting under IFRS for the utilities. Given guiding Principle #4 in Section B above, the Board should continue to take into account changes to accounting standards as it has done in the past under Canadian GAAP.

E. Impacts

There are three kinds of potential impacts related to IFRS. These are:

- ***the one-time administrative cost to switch-over to the IFRS based reporting;***
- ***the ongoing administrative costs for IFRS reporting including any related incremental costs for required regulatory reporting and;***
- ***impact on revenue requirement that may arise from changes in rate base and operating costs determinants, driven by changes in the timing of the recognition of expenses.***

For the purposes of sections 7, 8, 9 and 10 below, "modified IFRS" means financial accounting based on IFRS, with the modifications and exceptions for regulatory accounting identified by the Board in this consultation.

7. Rate Impact

7.1 Compared to rates established under current regulatory accounting, what are the direction and estimated magnitude of rate impacts created by establishing rates on the basis of various IFRS accounting options?

The potential impacts, if any, from the adoption of IFRS, will vary from utility to utility. The Board will require utilities to specifically identify financial differences and any resulting revenue requirement impacts that

arise from the adoption of IFRS requirements in the utility's first cost of service rate filing after IFRS adoption.

THESL RESPONSE:

THESL accepts this proposition based on its interpretation that "adoption of IFRS requirements" refers to modified IFRS. To the extent that modified IFRS differs from pure IFRS, any comparison to pure IFRS would be irrelevant. Please also refer to the Staff proposal under Section 9.4, which refers to modified IFRS in a similar context.

7.2 Should a mechanism be developed to phase-in or otherwise mitigate the rate impacts, if any, of adopting IFRS?

Rate mitigation or smoothing mechanisms currently used by the Board, such as the use of a deferral account and collection of accumulated amounts from ratepayers over a number of years, can be applied to reduce any rate impacts related to the adoption of IFRS, to the extent the Board permits recovery of IFRS-related costs.

THESL RESPONSE:

THESL accepts the proposition above but notes that rate impacts associated with recurring items such non-capitalization of overheads will presumably require repetitive, accumulating mitigation measures.

7.3 Should rate increase thresholds be set?

IFRS-related costs will be considered as part of the aggregate rate impact of all the changes included in the utility's rate application. An aggregate threshold of 10% on total bill may trigger mitigation. The applicant shall provide an analysis of the origin of the aggregate impact by individual cost drivers, an analysis of the impact on affected customer consumption, and a demonstration of the need for a rate smoothing mechanism.

THESL RESPONSE:

THESL accepts this proposition.

8. Utility and Shareholder Impact

8.1 Should the administrative costs (e.g. new systems, special audits, consulting) to transition to IFRS be recovered from ratepayers? On what basis?

Prudently incurred administrative incremental costs directly related to the transition to IFRS will be recovered from ratepayers on the same basis as other costs. This applies to utilities filing for rates on a cost of service basis and to utilities on an incentive rate mechanism. Where the utility incurs incremental costs related to transition to IFRS during a period for which rates have already been set, and for which the Board did not consider such costs, the utility may record in a Board-approved deferral account such incremental costs incurred after January 1, 2009 for consideration by the Board at the next cost of service proceeding. The Board, in determining the disposition of the account, will consider the criteria of causation, materiality and prudence.

THESL RESPONSE:

THESL does not agree with the Staff Proposal's reference to the date of January 1, 2009, for the following reasons:

- *In October 2008, THESL submitted a letter to the OEB requesting a deferral account for costs incurred for IFRS;*
- *THESL has incurred costs relating to IFRS, prior to January 1, 2009, which the Board should consider under the criteria of causation, materiality and prudence;*
- *Other utilities have also incurred IFRS costs in 2008, some of which utilities may have already obtained approval in their revenue requirement;*
- *THESL was requested by the OEB staff to present an update on its status of the IFRS project conversion in October 2008. THESL would not have been able to presents its project status without incurring the 2008 costs; and,*
- *Public filers, such as THESL, were required by the OSC to provide an on the status of its IFRS conversion in 2008 quarterly and annual filings.*

8.2 Should incremental on-going compliance costs be recovered from ratepayers? On what basis (z-factor treatment? threshold amounts?)?

Prudently incurred incremental administrative costs directly related to the compliance with IFRS will be recovered from ratepayers on the same basis as other costs. This applies to utilities filing for rates on a cost of service basis and to utilities on an incentive rate mechanism. Where the utility incurs incremental ongoing costs during a period for which rates have been set, and for which the Board did not consider such costs, the utility may record in a Board-approved deferral account such incremental costs incurred after January 1, 2009 for consideration by the Board at the next cost of service proceeding. The Board, in determining the disposition of

the account, will consider the criteria of causation, materiality and prudence.

THESL RESPONSE:

THESL does not agree with the January 1, 2009 date limitation for the reasons outlined in 8.1 above but accepts this proposition otherwise.

8.3 How can the Board encourage minimization of IFRS implementation costs?

Some suggestions:
- ***Joint depreciation study (including componentization)***
- ***Minimization of differences between IFRS requirements and regulatory requirements***
- ***A cooperative initiative among electricity distributors regarding accounting practices***
- ***Establish a threshold test similar to that used for Transition Costs (above threshold – more evidence or assurance required)***

THESL RESPONSE:

THESL agrees that the Board should encourage minimization of IFRS implementation costs. However, the Board should consider the following:
- *Joint depreciation studies are encouraged but do have limitations, as outlined above;*
- *Minimization of differences between IFRS requirements and regulatory requirements may not be feasible;*
- *Each electricity distributor has their own unique needs, and therefore a cooperative initiative for accounting practices may not be reasonable; and*
- *THESL objects to the use of threshold tests in these circumstances. Threshold tests can in practice be prejudicial and lead to perverse results, for example when through good management a utility is able to achieve lower-than-threshold costs but is nevertheless required to accept less-than-full recovery of those costs. Furthermore there is no indication in the Staff proposition above of how a threshold would be established; how it would take into account intrinsic differences in requirements between utilities (such as between utilities which are public filers and those which are not); or how the threshold would be expressed (for example, as a per customer amount, a fixed amount, or a blended fixed and per customer amount).*

8.4 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?

THESL RESPONSE:

The Board has asserted its authority over the determination of ratebase and revenue requirement for utilities regardless of the specific accounting conventions used by utilities for financial reporting purposes. In fact, it is the Board which would be adopting modified IFRS for ratesetting purposes and therefore any cost consequences of adopting modified IFRS must be considered prudent and recoverable from customers, subject to the Board's mitigation measures which themselves could not properly involve non-recovery of otherwise prudent and approved costs.

F. Filing and Reporting Requirements

9. Filing Guidelines for Rate Applications

9.1 What are the filing requirements for rate applications for entities regulated by the Board during and after the transition to IFRS?
See general description at end of section.

9.2 What financial filings should the Board require for use in cost of service rate applications for historical and test years subsequent to 2009?
See general description at end of section.

9.3 Should the Board prescribe any specific rate making measures in its incentive regulation mechanisms to take account of the adoption of IFRS?

No, except the establishment of a deferral account for costs related to implementation subsequent to January 1, 2009.

THESL RESPONSE:

THESL opposes the date of January 1, 2009 for reasons previously described.

9.4 Should rate applications under an incentive regulation mechanism be required to include a reconciliation of reported annual performance to the same financial reporting standard as that upon which the incentive framework was approved?

Not until rebasing - see general description below.

Rate application filing requirements prescribe the inclusion of financial data for a test year, bridge year and one or more historical years.

IFRS implementation requirements prescribe that entities report under both the existing CGAAP accounting framework and IFRS for the year 2010.

Proposal

1. For electricity distribution rate application filings:

For distributors making applications for rebasing in the summer of 2009 for 2010 rates:
The rate application filings should be provided under the existing regulatory framework (similar to CGAAP). The distributor may choose to present modified IFRS financial data in addition to filings under the current regulatory framework, with reconciliations between the current framework and the modified IFRS framework.

For distributors making applications for rebasing for 2011 rates:
For years prior to 2011, distributors will file the results under the current regulatory framework. For the 2011 test year, distributors will file forecasts under both the current regulatory framework, and on the basis of modified IFRS. In addition, for 2011, distributors will specifically identify financial differences and any resulting revenue requirement impacts that may arise from the adoption of modified IFRS requirements.

For distributors making applications for rebasing for 2012 rates and subsequent rate years:
For years prior to 2010, distributors will file the results under the current regulatory framework. For 2010 results, distributors will file results under both the current regulatory framework, and on the basis of modified IFRS. In addition, for 2010, distributors will specifically identify financial differences and any resulting revenue requirement impacts that may arise from the adoption of modified IFRS requirements. For the years subsequent to 2010, distributors will file results and forecasts under the modified IFRS framework.

2. For gas distributors making applications for rebasing for rates for years subsequent to 2010, and with an earning sharing mechanism in place:
For years prior to 2010, distributors will file the results under the current regulatory framework. For the rebasing test year, distributors will file forecasts under both the current regulatory framework, and on the basis of modified IFRS. Distributors shall continue to present all required IRM application filing materials using the current regulatory framework, while the current IRM is in place. In addition, for the rebasing test year, distributors will specifically identify financial differences and any resulting

revenue requirement impacts that arise from the adoption of IFRS requirements.

3. For gas distributors without an earning sharing mechanism in place: Same rules as for electricity distributors.

THESL RESPONSE:

THESL accepts the proposal as outlined.

10. Electricity Distributor and Gas Utility Reporting and Record-Keeping Requirements (RRR)

10.1 What changes are required to financial reporting requirements for entities regulated by the Board during and after the transition to IFRS?

See 10.2 to 10.6 for the changes that will be required.

10.2 Should the Board require all rate-regulated entities to report information to the Board using IFRS beginning January 1, 2011, regardless of whether they are otherwise required to use IFRS?

The Board will require all electricity distributors and gas utilities to report information to the Board using modified IFRS for regulatory accounting values and IFRS for audited financial statements beginning January 1, 2011, regardless of whether they are otherwise required to use IFRS.

THESL RESPONSE:

THESL accepts the proposal as outlined.

10.3 Should the Board require all rate-regulated entities to continue to report information to the OEB using Canadian GAAP until December 31, 2010 (regardless of early adoption by the utility)?

The Board will require all electricity distributors and gas utilities to continue to report information to the OEB using Canadian GAAP until December 31, 2010 (regardless of early adoption by the utility).

THESL RESPONSE:

THESL accepts the proposal as outlined.

10.4 Should the RRR include requirements for reconciliations between financial reporting under IFRS and regulatory accounting information?

The RRR will require reconciliations between financial reporting under IFRS and regulatory accounting information as follows:

For fiscal year 2010, reconciliations between:

- ***IFRS for financial reporting and modified IFRS for regulatory accounting (i.e. financial accounting based on IFRS, with the modifications and exceptions for regulatory accounting identified by the Board in this consultation)***
- ***CGAAP results and modified IFRS***

THESL RESPONSE:

THESL accepts the proposal as outlined.

For fiscal years subsequent to 2010, reconciliations between IFRS for financial reporting and modified IFRS.

THESL RESPONSE:

THESL accepts the proposal as outlined.

10.5 Should the RRR include a requirement for supplementary audit assurance regarding regulatory accounting values where they differ from IFRS reported values and that are not otherwise audited?

The RRR will include a requirement for supplementary audit assurance regarding regulatory accounting values reported on an annual basis where they differ from IFRS reported values in audited financial statements and that are not otherwise audited. The supplementary audit assurance will involve a full audit of regulatory accounting values by a third party auditor in accordance with attest audit requirements. The auditor will be required to express an opinion on the financial information in accordance with a predetermined standard.

THESL RESPONSE:

THESL accepts the proposal as outlined, provided that incremental costs of the supplementary audit assurance are recoverable in rates.

10.6 Should the periodic reporting to the Board by utilities under incentive regulation include a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved?

Reporting should be reconciled to the same basis of accounting as that upon which the incentive framework was approved.

THESL RESPONSE:

THESL accepts the proposal as outlined, provided that incremental costs of reporting such reconciliations are recoverable in rates.