EB-2008-0408

ONTARIO ENERGY BOARD

IN THE MATTER of the *Ontario Energy Board Act*, 1998, S.O. 198, c.15, Schedule B, as amended;

AND IN THE MATTER OF the review by the Board of issues relating to the transition to international financial reporting standards and consequent amendments to regulatory instruments

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FINAL SUBMISSIONS
OF THE SCHOOL ENERGY COALITION

May 25, 2009

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1 GENERAL COMMENTS

1.1 *Introduction*

1.1.1 On December 23, 2008 the Board initiated a consultative process to review the implications of the adoption by Canadian accounting standards bodies in 2011 of international financial reporting standards (IFRS). This process follows on a previous process (EB-2008-0104) in which an initial look at the scope of the problem was undertaken. The current process has included the gathering of some background information, several opportunities to exchange information, ideas, and analysis between parties and with experts, and now a two-stage written submissions process. All of this is being considered within the framework of a Board-approved issues list.

1.1.2 These are the submissions of the School Energy Coalition in this proceeding. We also expect to make reply submissions when the first round of submissions has been reviewed.

1.1.3 This process has already included a number of submissions from parties, including SEC, and an extensive consultative process. These new submissions have been informed by intervening events and completely replace previous submissions by the School Energy Coalition.

1.1.4 The exception is that, in the Technical Conference earlier this month, the School Energy Coalition provided a powerpoint presentation and oral comments, including Q&A. The views of SEC expressed at the Technical Conference in general continue to be our views (pending, obviously, review of the submissions of all parties in this matter), and these submissions should be treated as a more detailed supplement to that oral presentation and supporting material.

1.1.5 The views of the School Energy Coalition in this proceeding have been greatly informed and assisted by the expert advice of John Browne, who with the Board's permission was retained by eight ratepayer groups as a joint technical resource. Mr. Browne provided us with written analysis, and assisted us in several joint meetings where issues were discussed, analyzed, debated, and better understood by all attendees. We thank the Board for authorizing that retainer, and the special costs arrangements that flowed from it. It proved very effective.

1.1.6 Our views were also informed by regular consultation between ratepayer groups. In addition to the meetings with Mr. Browne, ratepayer groups had numerous exchanges of information and ideas, allowing many of our views to coalesce, and providing a better understanding of the concerns of the parties.

1.1.7 Finally, we note that the Board's process included detailed information and analysis from Board Staff and their expert advisors, and multiple opportunities to exchange views and questions with utilities and other stakeholders. That expertly-managed process was of considerable value to all parties.

1.1.8 As we did at the Technical Conference, we will in these submissions start with a review of the historical background, and the facts on which any analysis must be based. The next section then discusses the overriding principle at work, and the collateral principles that flow from it. It also presents the decision-making process that we believe is appropriate for the Board to use in fulfilling its statutory obligations and reaching principled decisions with respect to accounting-related issues. Finally, the balance of these submissions is taken up with detailed responses to the issues contained in the Board-approved issues list, and the Board Staff proposals on those issues, followed by a proposed action plan for consideration by the Board.

1.2 ***Summary of Submissions***

1.2.1 The submissions of the School Energy Coalition this matter can be briefly summarized as follows:

1.2.2 ***What is the Question?*** One question implicit in this consultation, and underlying all of the specific issues, is whether the current regulatory accounting system, which can be fairly characterized as CGAAP with modifications, should be replaced by a new regulatory accounting system that is, at its root, IFRS with modifications. Our answer is that this is likely inevitable, and at this point must be assumed to be the end state to which the current actions of the Board are directed. We believe that this is probably the consensus of the parties to this proceeding.

1.2.3 That having been said, we also believe that the more important question at this point in the process is not whether to move to IFRS today, but how to start that transition and continue it through the first few years. We believe that the move to a new regulatory accounting end state of IFRS with modifications will require considerable patience, while the IASB grapples with how IFRS should reflect North American regulatory realities, the utilities learn about the new rules and what the impacts of those rules could be, and the regulator gathers fuller information and develops new ways of modifying financial accounting to achieve regulatory goals.

1.2.4 Therefore, our submissions seek to distinguish between things that Board should determine today, and things that should be determined after further evidence and analysis.

1.2.5 ***The Basic Principle.*** As we noted in the Technical Conference, and at various other points in this process, in our view this is about setting just and reasonable rates, since that is the statutory mandate that gives the Board the right and obligation to consider these issues at all. The overriding principle flowing from that mandate that we believe should apply to the Board's consideration of these issues is the following:

The Ontario Energy Board has the sole responsibility and mandate to establish "costs" recoverable from ratepayers, and when and how those costs should be recovered.

1.2.6 ***Collateral Principles.*** Flowing from the basic principle are four other principles that we believe are also appropriate:

(a) It is neither good regulatory practice, nor legally allowed, for the Board to explicitly or implicitly allow an external body like the AcSB or the IASB to make rules affecting rates. Regulatory rules must be made by the Board, not by financial accounting bodies, and must be based on proper regulatory principles. Another way of putting this is to say that, in setting just and reasonable rates, we believe that financial accounting rules do not have a primary place. Rather, the Board should treat financial accounting rules as tools – among other tools – available to help the Board achieve ratemaking goals.

(b) In establishing rules as to the calculation of cost, impacts on the financial viability of utilities must be carefully considered, since maintaining the financial viability of regulated entities is an important component of the Board's responsibility for determining just and reasonable rates.

(c) The Board will continue to be faced with accounting changes at an increased pace into the near term, and so any approach that it takes to the current changes should be appropriate for the handling of those changes that arise next year, and the year after, as well.

(d) One of the principles of proper ratemaking is that rates are set based on evidence. Where the Board has insufficient evidence to make decisions on particular issues relating to IFRS, it should gather that evidence and then make those decisions. No credible case for urgency has been made sufficient to overturn the need for thoughtful policy decisions based on solid evidence.

1.2.7 ***Decision Tree.*** To comply with these principles in a rigorous and repeatable way, we have suggested that the Board adopt an approach based on a decision tree that we have proposed. The proposal, set out at Section 3.3 of these submissions, will in our view allow the Board to focus on the questions that matter, avoid extraneous analysis that does not lead to implementable conclusions, and help the Board to apply its expertise in the pursuit of its statutory mandate.

1.2.8 ***Specific Responses to the Board Staff Proposals.*** In Part 4 of these submissions, SEC provides comments and analysis with respect to each of the Board Staff proposals, in many cases highlighting how our proposed decision tree produces the recommendations we are making. One of the things that becomes apparent in this analysis is the extent to which, in respect of many of those issues, Board Staff is hamstrung in their proposals by the lack of sufficient information available to them on which to base proper analysis using accepted ratemaking principles.

1.2.9 ***Action Plan.*** Our submissions conclude with a proposed action plan. In response to the immediate issues presented, we propose three steps:

(a) For a small number of issues, such as the use of deferral and variance accounts, announcement of specific policy decisions in the Board's Report arising out of this consultation.

(b) For most remaining issues, establishment of a further process to obtain further information on which a proper analysis of ratemaking principles can be based.

(c) Adoption as a matter of principle of the proposed decision tree, or another policy framework consistent with it in principle.

To deal with the ongoing accounting issues as they will arise over the upcoming period of extensive change, we propose a new structure – a standing panel of the Board – or other approach developed by the Board, in order to achieve two key objectives:

(d) Notice to all interested parties of accounting issues that may have general application, as they arise, and

(e) Consistency of decisions on accounting changes as between hearing panels.

2 BACKGROUND AND FACTUAL BASIS

2.1 ***Historical Background***

2.1.1 The Canadian Accounting Standards Board ("AcSB") has made a decision that publicly accountable enterprises will, for reporting periods commencing on or after January 1, 2011 (with comparative figures for 2010 as well) be required to comply with IFRS, as established from time to time by the International Accounting Standards Board ("IASB"). Prior to that time, the applicable accounting standard was Canadian Generally Accepted Accounting Principles ("CGAAP"), as outlined in the handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook").

2.1.2 The problem faced by the OEB today arises because the OEB does not have a separate, internally consistent set of accounting rules for the entities it regulates. Rather, it relies on CGAAP, with certain exceptions that have been developed over time to reflect the conceptual differences between financial accounting and regulatory accounting (see below). Thus, the OEB faces a situation in which the basis for most of its accounting rules will simply disappear. The question that must be answered, and is at the root of this consultation, is

> **"Can the OEB replace CGAAP with IFRS as the foundation for its regulatory accounting system?"**

2.1.3 Regulatory accounting today is in fact the product of a lengthy and often subtle evolution in which the accounting rules themselves have adapted (formally or informally) to regulatory realities, and the regulator has developed methods of converting accounting information into a format more appropriate for regulatory purposes. This has been done largely on a case by case basis over many years, although it is also true that from time to time there have been more generic approaches applied to individual issues. For lawyers reading these submissions, a good analogy might be the common law. Although not fully enshrined in statute, the common law has developed a rich set of rules and practical applications through a case by case approach over many years. It has evolved to reflect changing external realities, and as a result of individual cases raising new issues or new perspectives on existing issues. As statutes have codified aspects of the common law, the case by case approach has continued through interpretations that fill in the details and determine application to specific types of situations.

2.1.4 One important aspect of this in the evolution of regulatory accounting was "industry practice", an implicit exception to some CGAAP rules that allowed regulated entities to fill in the blanks where the CICA Handbook was silent or contained flexibility, and even in some cases to ignore or modify the rules, to reflect the differences between a regulated entity and a competitive entity. In recent years, some utilities have looked to a U.S. standard, FAS 71, for guidance as to how to fairly reflect their regulated status in their financial statements.

2.1.5 But all of this change over time has created a situation in which regulatory accounting is really financial accounting with adjustments on both sides. IFRS does not have those adjustments built in, and arguably does not give sufficient flexibility to allow the OEB to make adjustments on the regulatory side.

2.1.6 In our oral presentation, we provided an analogy to try to portray this in a day to day example. Regulatory accounting today is like a motorcycle. What we got from the store many years ago is CGAAP, a road bike that is not really suitable for off-road trips (through forests, up mountains, etc.). We wanted to use it for regulatory purposes, in effect taking it off road, and to do that we have, through trial and error, introduced many modifications that make that possible. We reduced some weight, and changed the engine settings, and put on different tires, and now that bike – still at its core a road bike – is a serviceable trail bike as well. But, it's old, and the manufacturer is going to stop producing replacement parts and providing service at the end of next year. We are invited to buy a new road bike, IFRS, which is just as good as the old one, maybe even better. Unfortunately, that new bike has none of the modifications we have made over the years, and it doesn't appear possible to apply all of those previous modifications in the same way to the new bike. What we really should do is buy a specialized trail bike (i.e. a full and internally consistent set of regulatory accounting rules), but sadly there are none for sale. We can either keep trying to ride the old bike, or buy the new one (or perhaps both).

2.1.7 There is one other important historical fact. The history (and in particular the change from CGAAP to IFRS) is not finished. It is in a state of considerable flux and uncertainty, in part because the IASB is considering numerous changes to those rules, and in part because the entry into the world-wide IFRS family of Canada and the United States will certainly create pressures to modify or otherwise evolve existing IFRS rules between now and 2014. In short, this issue is not over. It is just beginning, and if anything it is likely to get more challenging in the next few years as issues – including some of the issues discussed here – are debated and resolved.

2.2 ***Financial vs. Regulatory Accounting***

2.2.1 A consensus appears to have arisen in the course of this consultation on one key fact: financial accounting and regulatory accounting have fundamentally different goals. Financial accounting seeks to achieve the fair (= non-misleading) presentation of historical financial information and the current status of a publicly accountable enterprise so that it can be relied on by third parties, in particular investors. Regulatory accounting seeks to achieve the fair (= balanced) determination of future forecasts, and the historical information that informs those forecasts, so that the regulator can determine just and reasonable rates. There is overlap between those two concepts (sometimes the most balanced approach is also the least misleading, for example), but their basic purposes are fundamentally different, and the principles applicable to the two cases will be different in many circumstances.

2.2.2 Perhaps the least controversial example of this difference of purpose is deferral and variance accounts. A company spends $1 million for a particular item. From a financial accounting point of view, the money has been spent (financial accounting is by its nature historical), so it cannot be treated as an existing asset in the financial statements unless it was spent to acquire or create a new asset of enduring value. Thus, the question dealt with by financial accounting is whether a new asset with economic value in subsequent periods has been created and, if so, what is the value of that asset. Any part of the expenditure that is not reflected in that future economic value is a current expense, and reduces current year profit.

2.2.3 Regulatory accounting answers different questions. First, it is likely to consider the expense at a time when the amount is not determinable. Second, in addition to determining whether, when the amount is known, it will create an asset of enduring value, regulatory accounting also has to answer two further questions: a) to what extent, if any, should the cost be borne by the ratepayers (purpose and prudence), and b) if so, how should that cost be apportioned between current ratepayers and future ratepayers (intergenerational equity).

2.2.4 In order to deal with these questions, regulatory accounting has developed deferral and variance accounts. In essence, deferral and variance accounts say "we will not deal with this expenditure in the period in which it is made, but we will wait and deal with it in a subsequent period when we have more information". At the time the deferral or variance account is created, the reason for it might be any of the various regulatory questions posed above, or a combination of them. In the simplest case (PGVA, for example), there is no real debate about who should pay, but determining the correct amount requires the actual data to be available. It cannot be forecast in an accurate way. In a more complex case (Class Action Deferral Account, for example, or Market Opening Costs), the Board is not in a position to determine to what extent the amount should be included in rates, and wants to wait for fuller information to make that decision. There are many other variations.

2.2.5 Financial accounting has no reason to have deferral and variance accounts. They do not fit with either the historical or the determinative nature of financial accounting, and so this is essentially an "alien" concept. In particular, the whole notion of making a decision not to deal with an expenditure – one way or another - in the period in which it is made is simply inconsistent with financial accounting. In financial accounting you can sometimes decide where to put an expenditure, but you can't just defer dealing with it.

2.2.6 Unless special rules are developed, the only way that financial accounting can deal with a deferral or variance account is as a receivable or payable. But, in keeping with the notion that financial accounting must not be misleading, the rules for receivables and payables are not symmetrical. To be recognized as a receivable, an amount must have a level of certainty, so that investors can rely on the expectation that the money will be received in a subsequent period. To be recognized as a payable, an amount must have a level of risk, so that investors can be prepared for the possibility that the money might be payable in a subsequent period.

2.2.7 It appears to be clear to almost all parties to this proceeding that regulatory accounting and financial accounting are completely and irretrievably at odds when it comes to deferral and variance accounts. This is not a problem with financial accounting, and it is not a problem with regulatory accounting. They have different purposes, and it is simply impossible given those purposes for the two types of accounting to handle deferral and variance accounts in a consistent way.

2.2.8 We have used the example of deferral and variance accounts because it does appear to be non-controversial. The same issue applies, or may apply, to many other issues in this proceeding as well. Above we have shown (as has Board Staff in their paper) the reasons why regulatory accounting has to produce one result, and financial accounting has to produce another result. In our submission, the Board has consider those same questions of purpose and structure when dealing with the other issues raised in this proceeding.

3 **APPLICABLE PRINCIPLES AND PROCESS**

3.1 ***Basic Principle***

3.1.1 The School Energy Coalition starts its analysis of how the Board should deal with the transition to IFRS from the perhaps-obvious principle that:

> **The Ontario Energy Board has the sole responsibility and mandate to establish "costs" recoverable from ratepayers, and when and how those costs should be recovered.**

3.1.2 We have repeated this in various forms a number of times in this proceeding, and we repeat it again here, because we believe it is valuable to dwell on the implications of this principle.

3.1.3 The Board has a statutory mandate to set "just and reasonable rates". In the context of the issues raised in this proceeding, it is that mandate and thus obligation that is the foundation of everything the Board does to deal with those issues.

3.1.4 Of course, that statutory duty has built into it many other considerations, such as balancing the interests of utility owners and their ratepayers, maintaining the financial viability of the utilities, etc. Some of those are explicit in the legislation, and some of those arise out of the interpretation over the years of the "just and reasonable" standard. But at the heart of all those things is that rate goal. It is the Board's *raison d'etre* and, as the Board often does in its own decisions and reports, it is useful to keep the focus on that goal.

3.2 ***Collateral Principles***

3.2.1 The basic principle leads to a number of other principles that the Board should apply in dealing with the issues in this proceeding.

3.2.2 First, and (surprisingly) most controversial, the Board should not – and in our submission, legally cannot – delegate the responsibility for determining any component of rates to an external body, whether it be the AcSB, the IASB, or anyone else. The Board can and should be informed and educated by the deliberations and conclusions of such bodies, but must in our view apply an independent regulatory analysis to the issues before reaching any conclusions that affect rates.

3.2.3 As we will note later, this means that the Board should not, either expressly or by implication, establish IFRS as the "default" for regulatory accounting rules. The Board can and should adopt some IFRS rules as regulatory accounting rules, either as is or with modifications, where the Board has reached an affirmative conclusion based on independent analysis that those IFRS rules or modified IFRS rules best achieve regulatory objectives and the Board's statutory mandate.

3.2.4 Second, the Board must continue to be concerned with the financial viability of the entities it regulates, and in that context should recognize that disjuncts between regulatory and financial accounting, if not properly managed, may as in the past create financial problems for regulated entities.

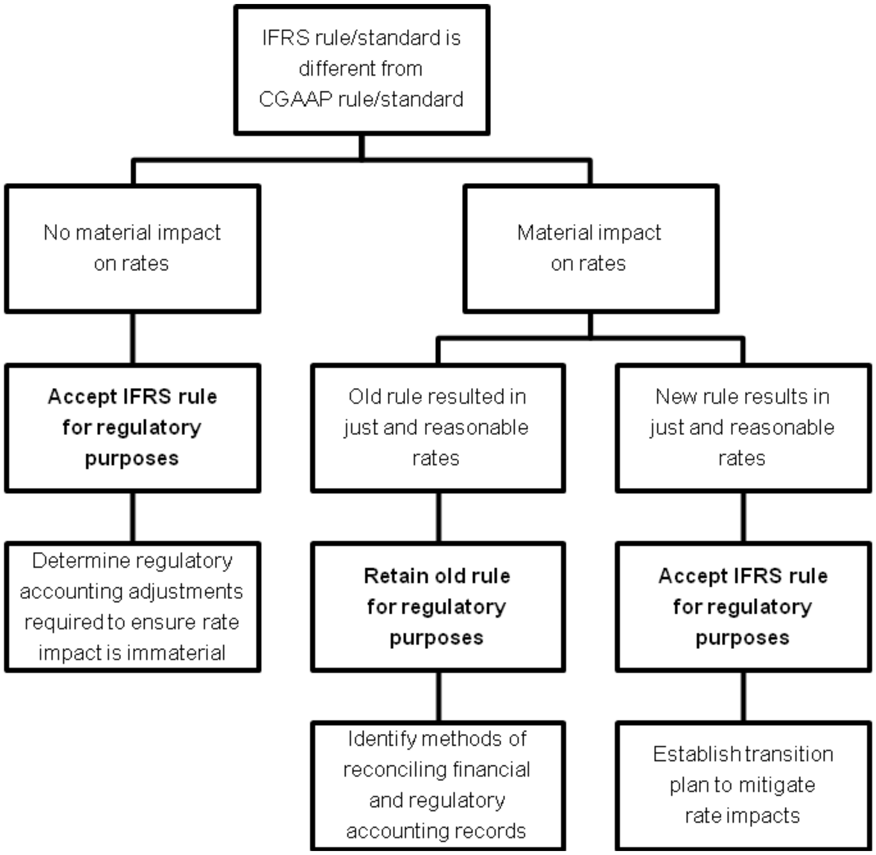
3.2.5 Third, the Board should recognize that it will be faced with these issues – changes to financial accounting because of and within IFRS – on a regular basis over the next few years. This means the Board should have an ongoing approach and structure in place to deal with those changes in a rigorous way that respects the Board's statutory mandate.

3.2.6 This last point underlines the special nature of the current situation. Currently, because the Board has a mature set of financial accounting rules, CGAAP, and a mature set of accommodations within regulatory accounting to deal with those rules, it has not had to make a big deal out of how individual Board panels handle changes to financial accounting rules. Arguably, it would have been better if there had been some kind of generic procedure in place, but there has not really been any urgency to do that. The situation is now quite different. Not only are there a number of significant issues facing the Board immediately, but there are already several others coming down the tracks that will arrive shortly. It is critical that, as each issue hits, the Board have an established and robust way of dealing with it. This will make the transition to IFRS more consistent and predictable, and considerably smoother.

3.2.7 Fourth, the Board must ensure that it has proper evidence to make substantive decisions on these points. By recognizing that decisions about the transition to IFRS are rates decisions, the Board also by implication must accept that since evidence is required to make rates decisions, evidence will be required to make IFRS decisions. Through our analysis in this section below, and on the individual issues in Part 4, we note areas in which evidence is required before the Board can reach a decision that affects rates.

3.3 ***Decision-Making Process***

3.3.1 Consistent with the principles we believe are applicable, SEC has proposed a decision tree for implementation by the Board in assessing the regulatory response to the current and any future changes in financial accounting standards. The decision tree is the following:



3.3.2 In applying this decision tree, in our submission there are five steps in the analysis.

3.3.3 ***Identify the Change.*** The Board must identify a change to which the decision analysis applies. To do this, the Board must have a clear understanding of the old financial accounting rule, the regulatory treatment of the old financial accounting rules, and the new financial accounting rule.

3.3.4 Obviously for the purposes of this analysis the Board is only concerned if the old rule and the new rule are different. If they are the same, it still may be legitimate to acquire whether either accounting rule is appropriate from a regulatory point of view, but that is a different issue outside the scope of the current consultation.

3.3.5 If the old financial accounting rule and the old regulatory rule were the same, and the new financial accounting rule is different, then a regulatory issue is raised. Similarly, if the old financial accounting rule and the old regulatory rule were different, and the new financial accounting rule is different from both, a regulatory issue is raised.

3.3.6 There will be many different variations on these possibilities, but the basic principle is the same. If there is a change in financial accounting rules, then the analysis is invoked.

3.3.7 ***Determine the Potential Rate Impact.*** As noted earlier, it is just and reasonable rates that will drive everything in this analysis, since that is the root of the Board's mandate. Thus, the Board must first determine whether an accounting change would or could produce a rate impact. If it cannot, then the IFRS rule should be accepted, and no further analysis is required.

3.3.8 A good example of this might be a change in terminology or formatting. If the IASB mandates that the Balance Sheet must be called the "Snapshot", this is not relevant to rates, and therefore the Board does not have to agonize over whether to adopt the change. A more complicated example might arise if the IASB allowed auditors to exclude the notes from their audit opinion. Although the change would not have a direct impact on rates, it could have an indirect impact by reducing the reliability of information the Board needs to set rates.

3.3.9 There may be other, more substantive, examples where changes do not have any real impact on rates. Consider, for example, the change in reporting of intangible assets. It may well be that, while being reported in a different way, things like computer software will still result in similar financial accounting dollar figures, so rates will not be affected.

3.3.10 For the Board to make this kind of determination, in our submission it must have an analysis of the potential rate impacts of the change if implemented as proposed, in all reasonable scenarios, applied to different types and sizes of utilities, and in different situations. The analysis should also include both present and future impacts. It is only if the impacts in all cases are *de minimis* that it is appropriate for the Board to conclude that it can accept the change without further substantive analysis.

3.3.11 It is important that the review not stop there, however. Changes that do not have rate impacts may still need a regulatory response in order to ensure that result. Examples may include intangible assets (which may be reported for regulatory purposes as if they were still PP&E), or contributions from customers.

3.3.12 We note that the Board may also determine that the impacts are *de minimis* for some utilities, but not for others. In those circumstances, it is submitted that the Board must deal with the change as a substantive one, applying the analysis below, but then consider whether to exempt certain regulated entities because the substantive impacts don't apply in their case.

3.3.13 ***Determine whether CGAAP or IFRS better results in just and reasonable rates.*** That is, the Board must determine whether the change to IFRS is a change in the direction of better rates, or worse.

3.3.14 In our submission, the correct way to do this is to ask – completely independently of both the old and new financial accounting rules – what is the optimum result from a regulatory perspective.

3.3.15 For example, CGAAP and IFRS have overhead capitalization policies that produce different results. The Board should consider the question "What amount of general overhead, if any, should be included in the asset value of capital assets, and in what circumstances?" If there is a current standard approach to the issue, then that approach will inform the Board's thinking, but it will not in itself be determinative. Where, as in this example, there is actually a range of past practice, the Board will have more of a blank page in answering the question.

3.3.16 But, in any case in our submission it is the rate question that must be answered first. Applying its own standard regulatory principles of matching of costs and benefits, intergenerational equity, and the like, the Board should reach a principled conclusion in answer to that underlying question. In reaching that conclusion, it does not matter what CGAAP or IFRS say is the rule. This is not an accounting analysis. It is a regulatory analysis. Neither CGAAP nor IFRS can assist the Board on the application of regulatory principles, because neither deals in any way with regulatory principles. That is the Board's expertise, not that of the IASB.

3.3.17 Still with the example, let us hypothesize that the Board reaches a conclusion, i.e. utility overhead should be allocated between capital and operating expenses based on a timesheet driven calculation of percentages of effort by executive, management and supervisory staff. The Board would reach that conclusion based on their assessment of which ratepayers should pay those costs: this year's ratepayers or those in the following years.

3.3.18 This has nothing to do with accounting. This is about just and reasonable rates. The Board concludes, in this example, that the cost of the work being done by management, for example, related to capital assets should be borne by future ratepayers as they use those assets. (We note that the Board might, conversely, determine that existing ratepayers are benefiting from the capital related work of management in past years, paid by past ratepayers, and so should bear the cost of management's work on current capital projects that will benefit future ratepayers. There are arguments for this position as well, but whichever position the Board determines is appropriate, the driver is rate principles, not accounting rules.)

3.3.19 This process of determining the appropriate amounts to be recovered from ratepayers, and when, relating to utility spending is at the root of the Board's expertise. We are not proposing that the Board do anything different than it does normally. Indeed, we are proposing that it NOT treat IFRS-driven changes different from any other proposal by a regulated entity to change what is being recovered in rates.

3.3.20 What is important, though, is that the CGAAP and IFRS rules are irrelevant to this analysis, because it is a rates analysis. It is only once the Board determines the right rates result that it then turns to the financial accounting rules, and assesses whether those rules – old or new – achieve the appropriate rate result. The financial accounting rules are – and it is critical to emphasize this – only a tool used by the Board to achieve regulatory goals. From the Board's point of view, they have no other value. Once the Board has determined where it wants to end up, in keeping with its mandate, it then must determine whether the goal is best achieved with one tool, or the other, or one or the other with modifications, or neither.

3.3.21 In our view, some parties to this proceeding have confused the selection of the appropriate tool with the identification of the appropriate goal. This step in the analysis, where the Board applies its specialized expertise, is primarily about the goal. Once that is established, selecting the best tool is the easy part.

3.3.22 ***Determine appropriate regulatory response if status quo is to be retained.*** This is a mitigation exercise, in which the Board looks at the impacts of keeping the status quo in light of the requirement that the utilities use an inconsistent IFRS rule for financial accounting purposes. Utilities may be affected by this inconsistency in immediate and ongoing direct costs, financial statement presentation, and internal systems compatibility.

3.3.23 In our submission, the Board has a full regulatory toolkit, which it has used in the past, to deal with differences between financial and regulatory accounting rules. It can establish deferral and variance accounts to deal with timing issues, for example. It can develop standardized methods of converting accounting information to regulatory information. It can allow full or partial recovery of incremental costs from ratepayers. These are just a few examples.

3.3.24 ***Determine appropriate regulatory response if IFRS is to be adopted.*** If the Board concludes that the use of IFRS for a particular issue better achieves just and reasonable rates, in our submission the Board is obligated to adopt IFRS. The question that arises in that case is also mitigation, but it is mitigation of the impacts on ratepayers rather than on regulated entities.

3.3.25 As with the impacts of retaining the status quo on regulated entities, so too in this case the Board has well understood tools for dealing with ratepayer impacts. They include phase-in approaches, deferral and variance accounts, and other techniques. Subject to our comments below, there is no principled reason – within this decision analysis - why rate mitigation would be different in the case of an IFRS change than in the case of any other change requiring mitigation.

3.3.26 The rate impacts of IFRS would appear to be more likely increases rather than decreases. This raises a particular concern. If a change to adopt IFRS produces a rate increase, the effect is that utilities, at the direction of the Board, are asking their ratepayers to pay more for the same service, even though the underlying economic reality has not changed. It will be understandable if ratepayers object to this, and we heard some of this in the consultations.

3.3.27 This question is different depending on whether the Board adopts the principled approach that we are proposing, above, or uses one of the other approaches proposed by the parties that starts from the accounting changes rather than the rate principles.

3.3.28 Take the example of an expenditure that, under the current rules, is a capital cost that is spread over time. Assume that the Board determines, based on rate-making principles, that it should really be a current expense borne by current ratepayers. Assume further that adopting IFRS would produce that result. In this example, the current ratepayers can't complain that their "new" rates should not include that expense. They are not being treated unfairly in that respect, because proper ratemaking principles have been applied. They may have been underpaying in the past, but the correction is to get fairer rates.

3.3.29 In that example, what the current ratepayers can complain about is the extent, if any, to which they are at the same time also paying for past costs in the same category that are embedded in PP&E. In that situation, they are paying twice, some part of the past costs and some part of the present costs. To deal with this, and get to rates that are more appropriate, the Board should be applying its standard practice of transitioning from old rules to new. Yes, there is a certain unfairness during the transition, but it is justified by the better long term result.

3.3.30 Contrast that with the situation in which the Board simply adopts an IFRS rule without determining that it produces fairer rates. Aside from the obvious legal issue, ratepayers can legitimately complain that their rates are being increased without any additional benefit, and without any underlying justification. Lacking proper application of rate-making principles, the Board does not have a reason to allow the rate increase without any change in the economic reality of the situation.

3.3.31 ***The Evaluation Framework.*** We note that the "Gang of 8" group of organizations representing ratepayers have proposed, through our expert Mr. Browne, a framework for evaluation of proposed changes to regulatory accounting rules. Our proposals above are not intended to be in opposition to the common evaluation framework. Rather, these proposals represent a similar analysis, but developed from a different perspective. The two are intended to be consistent on all important bases. We recognize that adoption by the Board of the decision tree approach we have advocated here would likely involve also adopting a practical process very similar to the evaluation framework proposed by Mr. Browne.

3.4 ***The "New" Regulatory Accounting***

3.4.1 We have, above, proposed that the Board adopt a rigorous and replicable approach to determining the regulatory response to financial accounting changes. During the course of the consultations, and particularly the Technical Conference, a more pointed question was being asked – the same question that we posed in paragraph 2.1.2 above. That is, should IFRS become the foundation on which regulatory accounting is based, in a manner similar to the relationship between CGAAP and regulatory accounting today?

3.4.2 It is a fair question, but in our submission it is not the most important question. We believe that the answer to that question must be yes. Whatever the problems associated with the transition to IFRS, it is simply impractical to expect that the Board or any other body will fashion an entirely new set of accounting rules from scratch. It is equally impractical to expect that the Board will, as a permanent solution, continue with CGAAP when it is a dead system no longer supported or administered by the accounting standards bodies. The situation in Canada is not similar to Europe and other countries, in which local GAAP was retained in parallel with IFRS. We will not have a local GAAP. As much as we might find it simpler or easier to adopt the same result as European countries, it is simply not possible.

3.4.3 No, in our submission the "end state" is conceptually much like the current relationship between financial and regulatory accounting: the financial accounting rules as a foundation, and the regulatory accounting rules built as a superstructure on that base. While the details of the adjustments to be made for regulatory purposes may end up being different, the fundamental structure of regulatory accounting is likely to be the same.

3.4.4 The mistake we believe some parties to this proceeding have made is to assume that the Board can simply jump to that end state, as if the Board had some kind of warp drive available that allows it to travel through a wormhole to its eventual destination.

3.4.5 The current relationship between CGAAP and regulatory accounting evolved over time. The same thing will happen with IFRS and regulatory accounting. Along the way, there will be changes to IFRS that will make it more "regulator-friendly", and there will be changes to regulatory accounting to adapt to IFRS rules. That evolution will not happen overnight.

3.4.6 This consultation is, in our view, about how to handle changes during that period of transition. Under the approach we have proposed, the Board accepts some changes to IFRS today, and mitigates their impacts. It also retains CGAAP on some other issues today, and mitigates the impacts of those decisions as well. Most important, though, the Board accepts that this transition is not going to happen in the next twelve months. It will happen over the next ten years, and the Board will have to have the patience and the long term view necessary to allow the appropriate evolution to occur.

4 RESPONSES TO THE ISSUES LIST

4.1 ***General Comments***

4.1.1 Although the primary submissions of the School Energy Coalition are set out in detail in Sections 2 and 3 above, and Section 5 below, we have in this section as the Board has requested provided our comments on the specific proposals of Board Staff on the Issues List**.**

4.1.2 We note that in a number of cases below, we have proposed that the Board defer its substantive decision until it has more information**.** We know that many regulated entities would like the Board to rush to decisions on all of these points, and in support of those recommendations they stress the urgency of the problem. In our submission, that overall urgency has been overstated. While it is true that on some issues delay could be very costly (and we will identify those below), on most issues delay is not a problem, and rushing blindly to a decision is neither necessary nor good rate-making.

4.1.3 During the Technical Conference, some regulated entities (notably Union and Enbridge) expressed a contrary view. In different ways, they expressed the view that both additional information, and additional change in the external environment, will unfold over the next couple of years, so making hard and fast decisions today is premature. We agree with those sentiments. In the rare cases that a decision must be made today, the urgency should be undoubted, and that should be the exception to the rule. For most aspects of this transition, patience and review of additional information will assist the Board in making better decisions, whereas earlier decisions would likely not be as good.

4.1.4 We note that Union and Enbridge have the most experience of all the Ontario regulated entities with ongoing rate regulation. That additional experience may be at the heart of their willingness to be more patient. On the other side, the "hurry, hurry" the Board is hearing from the electricity distributors may in fact be a reflection, not of real urgency, but of uncertainty. Enbridge and Union, facing the same uncertainty, have responded by saying "Let's take our time and get this right." While we do not always agree with Enbridge and Union on regulatory issues, on this one their experience is showing. They know, as does the Board, that the risks that appear to be buried in uncertainties such as this transition are rarely as bad as they first appear, are usually manageable to a greater or lesser extent, and are almost always exacerbated if decisions on how to handle them are not as thorough and well-thought-out as possible.

4.1.5 We also note, in this regard, that at least Hydro One, and perhaps other utilities, will be filing detailed impact information relating to IFRS in the near term, and other utilities will be developing that information over the next several months. Thus, any decision by the Board to take more time and get a more complete data set on which to consider some of these issues is not likely to involve a lengthy delay.

4.1.6 Finally, on the question of urgency, we note the comments of KPMG at the Technical Conference confirming that the IFRS standards applicable to both 2010 and 2011 financial information will be those in effect on December 31, 2011. Thus, until that time the Board and the regulated entities will not even know for sure what are the new rules they have to consider. In our submission, this is clear evidence that, with few exceptions, there is ample time to get better information and make more fully informed decisions on these issues.

4.2 ***Section 1: Principles***

4.2.1 Board Staff has proposed four principles for application to this transition. We have the following comments on those principles.

4.2.2 ***Principle 1 – Primacy of Board and Regulatory Requirements.*** We strongly support this principle, as noted in our earlier analysis. However, we agree with the submissions of BOMA & LPMA that the last sentence is inappropriately worded. In our submission, it should be replaced with:

> *"Regulatory principles will be the primary driver of regulatory requirements, and IFRS accounting requirements will only be adopted if they best achieve those regulatory principles."*

4.2.3 ***Principle 2 – Principles to be Applied***. We agree with this principle.

4.2.4 ***Principle 3 – Effects on Customers and Shareholders.*** We agree with this principle. Some parties have argued, or will argue, that either customers, or shareholders, or both, should be held harmless in this transition. For the reasons we have discussed in more detail earlier, we believe this is unrealistic. The transition to IFRS will inevitably have impacts, and the extent to which those impacts are felt by customers, shareholders, or both, will be determined by the Board. We cannot ask the Board to do the impossible by preventing any impacts from occurring. What we can ask the Board to do is assess, approve, and allocate those impacts fairly, based on sound regulatory principles.

4.2.5 ***Principle 4 – IFRS as the Default Rule.*** As we note in Section 3.4 above, acceptance of IFRS with modifications as the end state for regulatory accounting should not imply that decisions on individual issues today should adopt IFRS as the default position.

4.2.6 Using the decision process we have proposed, there is technically no overall default position. If IFRS has no rate impact, then in that limited class of cases it is accepted with whatever adaptations are necessary in the circumstances. However, in every case in which the Board's primary jurisdiction – just and reasonable rates – is engaged, there is no default financial accounting rule. There is only a rate decision, following proper ratemaking principles, followed by a choice of the appropriate financial accounting tool to achieve that rate decision.

4.2.7 What that does imply is that, until the Board makes a rate decision about a particular IFRS-related issue, rates are not changed. This is not because CGAAP is the default. Rather, it is because the decision has not yet been made.

4.2.8 What the IFRS as a default rule would imply is that, until the Board can apply proper ratemaking principles to a particular issue, it should make an interim rate change from CGAAP to IFRS. Making a rate change without applying proper ratemaking principles is neither legal nor good regulation.

4.2.9 We don't like the idea of default provisions. They imply that intellectual rigour is not required, i.e. decisions can be made without a thoughtful process. This is neither appropriate, nor the Board's practice.

4.2.10 To avoid this, we are proposing a different principle, to replace Principle 4. It can be worded as follows:

> *"All changes to regulatory accounting rules used by the Board, and regulatory reporting requirements established by the Board, will be made only as a result of the application of sound regulatory rate making principles. Any proposal to make such a change prior to, or in the absence of, that analysis will be unacceptable to the Board."*

4.2.11 ***Principle 5 – Standardization and Flexibility.*** We strongly support this principle. We note that some parties may feel that the proposed wording does not fully adopt the principle of flexibility, and if that is the case it would be appropriate to modify the wording to make that more clear. In our submission, the principle in its final wording should establish that all utilities should be subject to a single, standardized system of regulatory accounting, subject only to utilities demonstrating in a rate case that the underlying rationale for that standardized system does not, on a given issue, apply to them.

4.3 ***Section 2: Regulatory Assets and Liabilities***

4.3.1 Board Staff have proposed that the Board make an initial policy determination that it will continue to use deferral and variance accounts in the current manner, regardless of the IFRS treatment of those accounts. They have further proposed:

(a) Until the IASB completes its review of the treatment of these accounts, the Board should not make any changes to how those accounts are set up and cleared.

(b) In the meantime, financial statement impacts of deferral and variance accounts

should be managed by utilities through appropriate notes to the financial statements.

4.3.2 SEC offers four comments on these proposals:

(a) Consistent with our proposed decision tree, we agree with the proposal to make an initial determination to continue using deferral and variance accounts. It is clear that cessation of their use would have significant rate impacts, both short and long term, and would fundamentally alter the regulatory structure the Board has used for decades. Since financial accounting and proper ratemaking will always have timing differences, a structure is necessary to achieve that result, and IFRS contains no tool to do so. Thus, proper ratemaking principles require the retention of deferral and variance accounts.

(b) This is one example of an issue in this proceeding that should be decided today, not later, for two reasons. First, both the extent of the impact, and the direction of the obvious solution, are easily determined. Further information, while probably available later, is not likely to provide much in the way of additional assistance in the analysis. Second, without deferral and variance accounts the current way utilities are regulated is probably not viable, meaning that until the decision is made both utilities and ratepayers would have unacceptably high uncertainty about how rates will be set in the future. Not knowing how a particular rule will apply is one thing. We can deal with that. Not knowing what regulatory compact will apply is entirely different. In short, if the Board is going to fundamentally rethink its approach to economic regulation, we all need to know that now. If not, let's get past that issue and get on with the details within the current system.

(c) Consistent with the first two comments, we agree that <u>how</u> deferral and variance accounts are used should not be changed until the position of the IASB becomes clearer. Not only do we lack sufficient information, but there is no urgency to nail this down. Next year is soon enough.

(d) In the meantime, the proposal of Board Staff that utilities handle the transitional period through financial statement notes is a reasonable approach. However, we caution the Board that it is premature for the Board to be involved directly in that activity. It is, of course, outside of the Board's expertise in any case. More than that, until the IASB's rules on these accounts, and on what sort of note disclosures will be allowable, are known, the Board would be participating without any solid foundation. At some point in the future, it may be a good idea for the Board to establish – after appropriate consultation and analysis - a written policy on deferral and variance accounts, perhaps even changing their structure or establishing different categories. The time to do that, if at all, will be when the IASB has completed its review, and the Board knows what disclosure or other problems it actually has to address. Until then, in our view the Board can provide no useful assistance to the utilities in their financial statement presentation.

4.4 ***<u>Section 3: Property, Plant and Equipment</u>***

4.4.1 There would appear to be nine separate regulatory accounting issues raised in this section. We have provided our initial comments on each in our presentation at the Technical Conference. We summarize and in some cases expand on those comments here.

4.4.2 ***3.1 Opening Rate Base***. Board Staff has proposed that all regulated entities be required to calculate their opening rate base on transition to IFRS on the basis of regulated net book value. The alternative would be fair market value.

4.4.3 The regulatory principle in play here is that ratepayers pay in rates for the actual expenditures prudently incurred by the regulated entity, whether capital or operating costs, plus a fair return. Any change to use fair market value would be a fundamental change to the basis on which rates are set, and would clearly have a significant rate impact. It would change not only the amounts to be collected in rates, but also the allocation of risks and rewards between regulated entities and their customers. Therefore, applying regulatory principles properly, the status quo must be maintained regardless of IFRS.

4.4.4 We assume that Board Staff's proposal does not include restating any of the past calculations of rate base to be consistent with IFRS rules for asset cost calculations. That is, closing rate base on December 31, 2010 under the old regulatory accounting rules is equal to opening rate base on January 1, 2011 under the new regulatory accounting rules. It would be worthwhile if the phrasing were clarified to remove any doubt on this point.

4.4.5 It is not clear to us how significant the impact of the Board Staff proposal could be on regulated entities. Some have suggested that they will be able to use regulated rate base as the fair market value for financial accounting purposes.. That is not obvious to us, but we believe that the implications of this regulatory decision on the financial statements of regulated entities will become clearer over the next couple of years. When that additional information is available, the Board will be in a position to assess whether some form of mitigation for utilities is necessary if material impacts are arising.

4.4.6 This is a second situation in which a relatively quick decision on the regulatory result is appropriate. As with deferral and variance accounts, the materiality of rate impacts is known, if with only moderate precision. In addition, utilities will need to establish opening balances in 2010 for IFRS purposes, and if fair market value were to become the standard, might have to start arranging valuations today. Thus, knowing the Board's policy direction today is of significant value, and the additional precision that could be obtained by making the decision later is relatively insignificant.

4.4.7 ***3.2 – Additions to Rate Base and Ongoing Reporting.*** Board Staff has proposed that the historical cost of all assets continue to be the foundation for rate base calculations into the future. For the same reasons as our conclusion on opening rate base, we agree with Board Staff's proposals.

4.4.8 ***3.3 – Capitalization of Overheads.*** IFRS will impose restrictions on the amount and types of overhead costs that can be included in the capital costs of assets for financial accounting purposes. Board Staff has proposed that the Board require use of IFRS capitalization principles for regulatory purposes. We strongly disagree with that recommendation. In our view, this issue does not need to be determined at this time, and considerably more information is required before the Board can even begin the analysis. When it does so, we believe that the implications of moving to IFRS will be more complex than they currently appear.

4.4.9 There are several aspects to this problem.

4.4.10 First, it is in fact the case that overhead capitalization policies of entities regulated by the Board are all over the map, so adopting IFRS will have the advantage of standardizing treatment. However, with the greatest of respect, the fact that there is not a consistent current policy is not a reason for a particular standard. It is a reason for having <u>some</u> standard. The standard selected still must be based on proper ratemaking principles. Until that analysis is done, there is no basis on which to propose a move to IFRS.

4.4.11 Second, it would appear to us that the conceptual difference between many existing overhead capitalization approaches and the IFRS approach is, in fact, the difference between fully allocated and incremental cost allocation. This only became apparent (at least to us) at the Technical Conference, but it is an important fact when considering regulatory principles.

4.4.12 Incremental cost allocation is not by definition wrong in the context of capitalization. However, it is contrary to the cost allocation approach that the Board uses in virtually all other aspects of rate regulation where fairness is a key consideration. Thus, it is the basis of cost allocation between regulated entities and their affiliates, between regulated and unregulated activities within a regulated entity, and between different customer classes for costs of regulated activities. In every case, the reason for the use of fully allocated costing is that different people are bearing the cost, and the goal of the regulator is to ensure that the allocation is fair as between them.

4.4.13 In the case of overhead capitalization, the issue is the allocation of cost responsibility between current ratepayers and future ratepayers (i.e. intergenerational equity). While we understand that there might be an argument in favour of making an exception to the normal rule for this category of allocation, to the best of our knowledge that argument has not been made. If it were, we can fairly assume that some parties would have strong replies to that argument, but at this point we are not there yet. The Board's standard approach to allocation of cost responsibility between ratepayers or activities is fully allocated costing, and there is nothing before the Board yet on which it could reach a contrary conclusion.

4.4.14 Third, neither the nature nor the size of the impacts of such a change are known at this time. Enbridge has, in their submissions, sought to give the Board a sense of the potential magnitude of the impacts on the shareholder, and that is very useful, but it is still only part of the story. For example, if you take the figures contained in Appendix A to their Submissions, and add the impact on recoverable interest and operating costs included in rates, you will see another side, as follows:

	1	2	3	4	5	6	7	8	9	10
Overhead Capitalized										
Depreciation	88	96	104	112	120	128	136	144	152	160
Return on Equity at 10%	155	166	177	187	197	207	217	226	235	243
Interest on Debt at 7%	193	207	220	233	245	258	270	281	292	302
Additional Overhead in Opex	0	0	0	0	0	0	0	0	0	0
Total Cost to Ratepayers	436	469	501	532	562	593	623	651	679	705
Overhead Under IFRS										
Depreciation	87	94	101	108	115	122	129	136	143	150
Return on Equity at 10%	153	163	172	180	189	197	205	213	220	227
Interest on Debt at 7%	190	203	214	224	235	245	255	265	274	282
Additional Overhead in Opex	50	50	50	50	50	50	50	50	50	50
Total Cost to Ratepayers	480	510	537	562	589	614	639	664	687	709
Addition to Rates	45	41	36	30	27	22	16	13	7	4
Cumulative Rate Increase	45	86	122	152	179	200	217	229	237	241

4.4.15 Thus, as one would expect, the impact in this example is that, once the ratepayers bear a significant cost ($241 million) in additional rates over the first ten years, they enjoy an increasing annual benefit over the subsequent years. On the other hand, the income earned by the shareholder is reduced, and continues to drop annually and on a cumulative basis (at least $91 million in the first ten years) into the foreseeable future.

4.4.16 The point of this example is not to show that ratepayers or shareholders are unduly advantaged or disadvantaged by the Board Staff proposal. Rather, it is to show that the impacts on both are long term, complex, and potentially very material. Further, this is only one example. There is no reason to believe that this Enbridge-based illustration of the impacts will apply in the same way, or even in a roughly similar way, for Hydro One, or Toronto Hydro, or EnWin, or anyone else.

4.4.17 The fact is, the Board simply is not in a position to estimate the impacts over time of a change to IFRS capitalization policies. A year from now, when Hydro One, Toronto Hydro and others have filed applications that include the impacts of IFRS, there will be more information available to deal with this issue. Until that time, any decision the Board makes on this point will be no more than a guess, without evidence to back it up. Yet, the impacts could be both significant and unpredictable.

4.4.18 This is a good case to show how the decision tree we propose would assist the Board.

(a) Applying the decision tree, it is clear that there is not enough information to determine that the impacts are *de minimis*, or that in general they will be material for most utilities, although the latter is likely. What is clear is that a move to IFRS on the basis of negligible impacts is not supported by what we know so far.

(b) If we then take the next step (what is most likely to produce just and reasonable rates), we can see that there is a critical issue of principle that has to be addressed (fully allocated vs. incremental cost allocation). We can also see that there is at least the potential for significant shifting of costs both over time and between ratepayers and shareholders, and the full extent of, and drivers for, that shifting are not yet known. For example, it is clear that there may be a tradeoff for ratepayers between higher rates today, and lower rates in the long term, but at a cost to the utility of lower profits, and potentially reduced financial health, in the long term. All sorts of ratemaking principles are engaged by this information, but we have only one hypothetical snapshot of part of the problem. In short, the information currently available is insufficient to determine whether IFRS or some other standard is the best way to handle overhead capitalization in a ratemaking context.

(c) Thus, the decision tree approach would require all utilities to continue their existing overhead capitalization policies until the Board can gather enough information to make a decision on the appropriate standard to employ, and any exceptions that might be applicable. The Board's action item, in that situation, is to develop a plan to gather that information as quickly as possible, perhaps through a generic proceeding like the deferred PILs matter currently before the Board, or through a consultation, a survey, an expert study, or any number of other avenues for investigation.

4.4.19 [We note that, since the Enbridge submissions were filed earlier in the day on May 25, 2009, we have thus been able to consider them in these submissions, rather than in reply submissions**.** We have in general avoided doing that in these submissions, except where other parties have shared drafts with us in advance. In this particular case, we felt that the Enbridge example was a useful starting point, and that by dealing with in in these submissions, we would afford Enbridge the opportunity to add further analysis of this difficult question in reply, should they choose to do so.]

4.4.20 ***3.4(a) – Interest Component of Capital Projects.*** Board Staff has proposed that the AFUDC approach be replaced with an IFRS approach, in which the actual borrowing costs incurred during a capital project be capitalized as part of the project costs. While we believe that Board Staff's proposal may on full review have merit, it is submitted that the Board has insufficient information to make this determination.

4.4.21 Without going into a detailed analysis of this issue, we believe that at least the following sub-issues have to be addressed by further information, examples, and analysis, before the Board can decide this issue:

(a) To what extent, if any, do utilities today follow the Board's AFUDC regulatory accounting rule in their financial accounting? If they often or sometimes do not, to what extent would a different financial accounting rule, i.e. IFRS, make it more difficult for utilities to deal with the difference between financial and regulatory accounting rules? Depending on the facts, it may turn out to be the case that retaining the current regulatory rule is completely consistent with a move to IFRS for financial accounting purposes.

(b) How would the current approach to affiliate debt have to be revised or augmented to deal with situations in which it is the actual cost of affiliate debt that is being capitalized into PP&E amounts for regulatory as well as financial accounting purposes? How would the Board protect ratepayers while accepting the IFRS rule, and, if such ratepayer protection resulted in differences between actual debt costs capitalized and deemed debt costs capitalized, how would that be handled within IFRS?

(c) To what extent, if any, would the Board have to limit the freedom of regulated entities to choose which debt applies to which activity, in order to prevent gaming of the rules? How would any such limitations affect congruency between financial accounting records and regulatory accounting records?

(d) If protections are required in order to use IFRS, what is the additional compliance cost associated with those new rules, and who is responsible to pay those costs?

4.4.22 We could undoubtedly give a dozen more examples of sub-issues that arise in considering this issue. And for each of them, as with those noted above, the Board would not really be able to assess the best way to deal with them, consistent with sound ratemaking, without having a sufficient spectrum of real life examples to aloow the consequences of any given policy to be seen clearly.

4.4.23 We also note one more general point that may be relevant in this context. AFUDC is an example of a Board policy in which the Board effectively says to regulated entities "The amount you actually spend on item X is not going to be determinative of recoverable costs. We will instead determine a generic or formula amount which is in our opinion a reasonable budget for item X. That is what you may recover from ratepayers. If you spend more or less than that amount, that is for the shareholder's account."

4.4.24 This is not the only situation in which the Board sets a policy in that way. If in the case of the interest component of capital projects, that is no longer appropriate, the Board should address whether the use of generic or formula budgets is itself still appropriate. If not, why not? If so, how is AFUDC different from other situations in which a formula is used for cost recovery in place of actual costs incurred?

4.4.25 ***3.4(b) – Customer Contributions***. Board Staff has proposed a treatment of customer contributions for regulatory purposes that continues the existing rate result while allowing IFRS compliance for financial accounting purposes. That would appear to be a good result.

4.4.26 ***3.4(c) – Intangible Assets.*** Board Staff has proposed that where intangible assets are no longer to be included in PP&E under IFRS, they continue to be treated for regulatory purposes in a similar way, consistent with both existing regulatory treatment and IFRS treatment. It is suggested that there is no revenue requirement impact of this approach.

4.4.27 In our view, if that is the case, then it would appear to us that the Board Staff proposal is a good one. However, we have not seen any data that supports this conclusion. It would be useful for Board Staff to bring out some real life examples to show how the proposed treatment maintains the status quo on rates.

4.4.28 Board Staff also does not deal in their proposal with the IFRS asset impairment rules for intangible assets. An annual test of impairment would appear to be required. If there is impairment found for financing accounting purposes, it will be necessary to address whether it is recognized for regulatory purposes and, if so, how if at all (since it is after the fact) it would be recognized in rates. We have seen no information in this proceeding that would allow the Board to reach a conclusion on this point, which clearly could have a material impact on either ratepayers or utilities, depending on what resolution is being considered.

4.4.29 ***3.4(d) – Asset Retirement Obligations***. Board Staff appears to have proposed that this issue be handled on a case by case basis. While we agree that there will be some instances where that is the right approach, we still believe that the Board should consider the issue in more detail, and reach some general conclusions on policy issues relating to this area. That should come after further information has been gathered.

4.4.30 Recently, the Board has considered asset retirement obligations in the context of Ontario Power Generation. Because of the complex history, and the statutory funding and other rules applicable in the case of OPG, it is clear that any general policy of the Board relating to asset retirement obligations is not likely to be applicable to OPG. However, what the OPG proceeding brings into stark relief is the fact that the question of asset retirement obligations is complicated, and can potentially involve significant issues of intergenerational equity.

4.4.31 Against that background, we have four comments:

(a) It appears from what was said by a number of people at the Technical Conference that in the case of asset retirement obligations, as with overhead capitalization, there is little consistency in current treatment between utilities. That suggests that consideration of a standardized approach may be useful, but as with overhead capitalization it does not suggest what the approach standard should be.

(b) The fact that OPG is a special case does not imply that all, most or even any other regulated entities are so special that standardized rules cannot apply to them.

(c) A review of the issues considered in the OPG case revealed that some of those issues, particularly those considering the balancing of interests between present and future ratepayers, are not only complex, but also potentially applicable to many other regulated utilities. That suggests that a generic review of this issue by the Board based on information from a number of utilities could allow those common issues to be aired in a thorough way, even if in the end some categories or subsets of regulated entities have to be dealt with on a case by case basis.

(d) In the OPG situation, the issue of "catch-up" recoveries was established by government decision rather than regulation. In the case of all other regulated entities, the issue of catch-up, which is one of general application, is left to be decided by the regulator if asset retirement obligations are to become a standard part of ratemaking.

4.4.32 It is therefore submitted that, with respect to asset retirement obligations, as with overhead capitalization, the Board should not adopt the Board Staff proposal, but should instead establish a process to gather further information and then consider in a generic way whether common policy issues can be determined using that information.

4.4.33 ***3.5(e) – Gains and Losses on the Disposition of Assets.*** Board Staff has proposed reporting results for this change in a manner that effectively continues current practice. We have no objection to that result, as it is consistent with our proposed decision tree approach in the short term. However, we have not seen any information on the record in this proceeding that would allow this result to be retained indefinitely into the future. At some point, we believe that the Board should address this question based on a range of concrete numerical examples, and establish some standards going forward.

4.4.34 In this regard, we agree with the conclusion of BOMA/LPMA that the Board Staff proposal may result in an increasing divergence over time between accounting and regulatory fixed assets. The Board should assess the magnitude and impacts of that divergence before establishing a long term resolution of this issue.

4.4.35 ***3.5(f) – Asset Impairment.*** We have commented separately above on the question of asset impairment for intangible assets. Board Staff have proposed that, as a general matter, asset impairment losses should be reported separately so that the Board can determine on a case by case basis how it should be handled for rate purposes.

4.4.36 It would appear to us that situations of asset impairment can probably be categorized into two or more groups, each of which have common attributes and common policy issues that apply. For example, assets that become redundant due to changes in government regulations, such as smart meters, may be a distinct category with common elements applicable for ratemaking purposes. On the other hand, assets that must be written off because they did not prove useful for as long as the utility planned may have different policy considerations. There may be another category of assets that are still perfectly usable, but are replaced because the utility can drive future efficiencies with a newer technology. In each of these categories, and perhaps others, one can see that it may be possible to establish a common, principled rule applicable to all asset impairments in that category.

4.4.37 Thus, in our view the end state for the asset impairment question will likely be a number of rules or guidelines applicable to specific types of asset writedowns. If what Board Staff is proposing is that the Board use a case by case approach while it develops a sufficiently robust data base of examples that it can establish the categories and generic rules, we think that approach has merit. The case by case approach would be a method of developing generic rules in an efficient manner.

4.4.38 On the other hand, if the Board Staff proposal is that asset impairment be treated as a one-off for all cases indefinitely into the future, that would not appear to us to be an appropriate goal.

4.4.39 In any case it would be useful, we think, for the Board to consider what general issues might be applicable in the case of asset writedowns, and in particular which past Board decisions on asset writedowns remain as valuable precedents today. This would allow future Board panels dealing with specific applications to deal with the asset impairment questions without having to reinvent the wheel in each case.

4.5 ***Section 4: Depreciation***

4.5.1 Board Staff has proposed that utilities continue to use their existing depreciation rates and a straight line depreciation methodology going forward. Any utility is free to file in its cost of service application a depreciation study specific to that utility, which would then, if accepted by the Board after due review, form the basis for rates. On these points, we support the proposal of Board Staff.

4.5.2 Board Staff has also proposed that a joint depreciation study be carried out for electricity distributors, with the expectation that it would be a) IFRS compliant, and b) the basis for depreciation rates for electricity distributors across the province. On this point, we have had an opportunity to review a draft of the submissions of

BOMA/LPMA, and we share their concerns.

4.5.3 The problem correctly raised by BOMA/LPMA is that it is unlikely that a generic depreciation study will in fact capture the real depreciation rates fairly applicable to an individual utility. As they point out, the lives of assets are affected by many factors that are not common to all distributors. In addition, as they note (and as KPMG said at the Technical Conference) it is not obvious that a generic study will be IFRS compliant for individual distributors. For these reasons, we agree that application of a generic study to each distributor cannot be made the standard or mandated.

4.5.4 That having been said, the Board has a practical problem. Many distributors do not have the resources to carry out a formal depreciation study, and the cost for a small utility may be unreasonably high. A generic depreciation study would at least result in the depreciation rates for some utilities being based on better information than is currently the case.

4.5.5 We believe that the appropriate approach in the near term is for the Board to carry out the proposed study, and make the results, including ranges of results with variables if possible, available to all electricity distributors. Distributors would then be free to determine how much or how little weight they apply to that study in proposing depreciation rates in a cost of service rate application. Ratepayers would also be free to argue that the approach proposed by the distributor is not the best for their situation. For a small utility, without special circumstances, they may wish to rely heavily on the province-wide study, and the ratepayers may well accept that it is a good pragmatic approach. For a larger utility, they may wish to do their own study on all or some material components of their PP&E. Whether or not they do, the ratepayers may propose a study, or a different study, and should be free to make the case for that choice. In still other cases, the utility or the ratepayers may propose that the conclusions of the province-wide study apply to the specific distributor, but with exceptions reflecting their unique circumstances.

4.5.6 Thus, while we agree with BOMA/LPMA that the generic study is not the end of it, that study can still have significant value by improving the information available to each utility when they propose their depreciation rates for rate recovery purposes.

4.5.7 One other comment is appropriate with respect to this issue. Board Staff appears to assume that new depreciation rates or methodologies will be consistent with IFRS. While that may well end up being true, Board Staff has presented no information in this proceeding that identifies the changes in rates that would result. Until that work has been done, and the information gathered, it is premature to assume that the IFRS rules on, for example, componentization and pooling, will be appropriate to adopt for rate making purposes. The Board will have detailed information from the generic depreciation study, the Hydro One application this year, and the Union Gas applications, at the very least. Consistent with the regulatory approach we have proposed, the Board can assess that information, and the applicable rate principles, to determine whether adoption of the IFRS solutions to these questions is the best way to establish and maintain just and reasonable rates.

4.6 ***Section 5: Others Issues in Points of Departure***

4.6.1 Board Staff has raised three issues under this heading: inventory valuation of natural gas, PILs accounting, and pension and other employee benefits.

4.6.2 ***Inventory Valuation of Natural Gas.*** We agree with the submissions of BOMA/LPMA on this issue, and thus support the Board Staff proposal.

4.6.3 ***PILs***. The Board Staff proposal is to continue with the status quo, in which regulatory accounting is different from financial accounting. That difference would not change dramatically under IFRS, so it would appear that no special action on the Board's part is required.

4.6.4 Some utilities have suggested that, under IFRS, it will be necessary for them to have a deferral account for future taxes. As we have seen in past Enbridge, Union and OPG cases, among others, the issues that arise when a utility wants to recover a tax differential in deferred taxes can be complex, particularly where the proposed recovery arises in the context of an asset disposition. We do not believe that this consultation has provided the Board with sufficient information to determine in a formal way the relationship between deferral of tax expenses, and future recovery of those taxes in various types of circumstances.

4.6.5 On the other hand, we think that this is an important issue, and it may become considerably more important in the future, particularly as GEA activities make the tax positions of some regulated companies more complicated. Therefore, we propose that the Board schedule, perhaps for next year, a generic review of recovery of tax obligations from ratepayers, and include in the issues for that review the question of whether a deferral account for future taxes is appropriate, and if so on what basis and with what rules.

4.6.6 ***Pensions and Employee Future Benefits.*** Board Staff have proposed that the current rules for recovery of these costs be maintained, but that individual utilities be free to include in their individual applications requests for different treatment of these costs. We disagree with that proposal.

4.6.7 If IFRS ultimately outlaws or severely restricts the smoothing of pension and future benefit costs through methods such as the corridor method, the impact on short term rates, and the resulting impacts on either rate or utility profit volatility, could be substantial. In the Technical Conference, for example, Union Gas noted that IFRS will require them to write off substantial unamortized losses, and they will be seeking a way of recovering this from ratepayers at some point. This is but the tip of the iceberg. We expect that the impacts in this category will be very material for many utilities.

4.6.8 The other fact that is relevant here is that pension and employee future benefit issues are highly complex, potentially requiring expert accounting and actuarial evidence to get to the root of the policy issues and impacts at play. Preparing even a simple example (like the one we provided earlier for overhead capitalization), is essentially impossible without expert assistance. As we saw during the discussion at the Technical Conference, even when an issue is apparently wrestled to the ground, there are additional complexities and surprises, e.g. the flow through of pension and future benefit costs to PP&E through capitalization rules.

4.6.9 Given those facts, it would appear to us to be inefficient, even dangerous, for the Board to leave these issues to individual rate cases. Not only would this raise the possibility of inconsistent decisions between Board panels, but it would also require a costly and time-consuming debate, with experts, in multiple proceedings. It would be like considering return on equity on a case by case basis. Just as the Board would not, we think, seriously consider that approach to ROE, so too a case by case approach to pension and future benefit costs is also not appropriate.

4.6.10 Therefore, it is submitted that a generic proceeding should, once the IFRS rules on these costs have settled into place, be set up to consider the views of all parties, a variety of fact situations, and the input of experts in the field.

4.7 ***Section 6: Decisions of Accounting Standards Bodies***

4.7.1 Please see our detailed submissions in Part 3 above.

4.8 ***Section 7: Rate Impact***

4.8.1 It is clear that adoption of IFRS could in some circumstances result in significant changes in rates and deterioration of rate stability. However, if the Board adopts the approach to considering accounting changes that we have proposed, the only circumstances in which IFRS would be adopted would be a) when there is no material impact, or b) where the resulting rates are more consistent with proper ratemaking principles.

4.8.2 Many parties to this proceeding have proposed that IFRS should be imposed without the application of ratemaking principles, and then rate impacts should be mitigated. This is fundamentally wrong, for the reasons we have set forth in our earlier analysis. In short, mitigating bad rates does not make them good. It does not even make them less bad. Only a principled approach to ratemaking can produce just and reasonable rates. Any other approach is, in our submission, contrary to sound regulatory policy and contrary to applicable law. No amount of mitigation can change that.

4.8.3 Where a change produces fairer, more appropriate rates, there can still be transitional impacts that should be mitigated. We do not believe that it is appropriate at this point to establish a mitigation threshold. The situation is not so complicated that the Board cannot first take a look at the situations in which there are material rate impacts, and assess at that point whether mitigation is required. Without examples, it does not seem useful to engage in a purely theoretical debate on the point.

4.9 ***Section 8: Utility and Shareholder Impact***

4.9.1 The first issue under this heading is the question of transition costs. In our view, this has several components:

(a) Should any portion of the base costs of transition to IFRS be the responsibility of the shareholder rather than the ratepayers?

(b) Should the Board establish deferral or variance accounts for utilities to record their IFRS transition costs?

(c) Should IFRS transition costs include costs of regular staff for time spent on IFRS and thus allocable to the IFRS work?

(d) How should the Board address IFRS costs incurred by utilities prior to the beginning of 2009, even though those rate years are now past? Should the treatment be different for utilities that asked in a timely manner for a deferral account prior to 2009, and were told to wait for this proceeding?

(e) How should the Board motivate the regulated entities to work together to reduce transition costs for all parties?

(f) Should transition costs for IFRS incurred during IRM that would not meet the Z factor threshold be recoverable from ratepayers?

4.9.2 In answering these various questions, we are acutely conscious of the fact that 80-90 companies are all going out and seeking solutions to the same issues, at the same time, and there is almost certainly significant duplication of effort as everyone chases the same goals. This was a problem in market transition, and we are concerned that it may become a problem in this transition as well. It may be less, as utilities have responded to the market transition experience with more common activities this time around, but we expect that it is still an issue.

4.9.3 In our view, the Board should allow each utility to recover in rates a predetermined IFRS transition allowance, based on a formula to be determined by the Board. At present, the Board has the rate applications of at least twenty electricity distributors that have forecast IFRS transition costs, plus estimates disclosed in this consultation**.** The Board should review that information (including all pre-2009 actual costs incurred and reported), and determine if it is sufficient to generate an algorithm for costs per customer, or per unit throughput, or as a percentage of revenues, or some other clearly defined metric. Then, since those costs have for the most part not been tested, they should be reduced, perhaps to 90%, and a standardized allowance developed. In the event that the information filed to date is insufficient for this purpose, the Board should gather forecasts from LDCs, test them through a mini-hearing process, and then develop the standardized allowance.

4.9.4 Once the Board develops a standard allowance, each regulated distributor should be given the right to amortize that allowance as a rate rider over a three year period to reflect the transition costs for IFRS.

4.9.5 The approach we are proposing has at least five benefits:

(a) The use of a standard allowance avoids cost and resources required for the detailed prudency reviews of each individual utility that would otherwise be required, and the potential for inconsistent results that plethora of proceedings would entail.

(b) By using a formula, the Board does not have to draw a distinction between pre-2009 and post-2008 spending. Those who, prudently, took an early look at these issues are not penalized. Those who asked for recovery in 2008, and those who declined to ask for recovery because this proceeding was upcoming, are not unfairly denied recovery. It is accepted that, whenever the tasks were done, they are a necessary aspect of moving to a new accounting regime.

(c) Utilities will be incented to keep their costs down, because if they are efficient the savings go to their bottom line. If the alternative, a deferral account, is used, utilities have a flow through of actual costs, so they do not have the normal incentive in cost of service regulation to minimize spending to budget. In this proposal, the allowance acts like a forward test year forecast, to which utilities can manage, successfully or not. For example, those who work together will do relatively better than those who insist on going it alone.

(d) The question of whether an exception to the gas or electricity IRM Z factor threshold should be made is avoided. If all utilities have a standard IFRS transition allowance, it applies to everyone regardless of their current IRM status. Differences based on your IRM terms, or the year of your rebasing, are not relevant.

(e) Any regulated entity that opts for an unusually expensive approach to IFRS (for example, full restatement of all historical PP&E, or full FMV calculations), would be free to do so, but it would be at the expense of their shareholder. The Board's recovery allowance would be sufficient to recover the cost of a standard transition, but extra bells and whistles would not be recovered.

4.9.6 If the Board agrees and adopts the cost recovery proposal we have set out, there are three obvious corollaries:

(a) Regulated entities who have included either capital or operating costs in rates already would have to net those out against the allowance.

(b) Capital assets purchased or built as part of the transition to IFRS would not be added to rate base, as the allowance would have covered all of their cost.

(c) IFRS costs should be calculated on a fully allocated basis, and should for example include an allocation of the costs of regular staff for their time on the IFRS transition project.

4.9.7 Once transition costs have been determined, utilities will still seek to recover ongoing costs**.** Board Staff has proposed that these costs be recovered on the same basis as other accounting costs. We agree.

4.9.8 However, we do not agree that a deferral account is required. As utilities come up for rebasing, their annual accounting costs (including the impact of IFRS compliance) should be forecast and justified in the normal course. While the transition is a one-time special case, the ongoing costs are just the costs of complying with the current accounting rules. The fact that those rules are different in 2011 as opposed to 2009 is irrelevant.

4.10 ***Section 9: Filing Guidelines for Rate Applications***

4.10.1 No submissions. We will be informed by the detailed submissions of the regulated entities, and may have comments on those submissions in reply.

4.11 ***Section 10: RRR Requirements***

4.11.1 No submissions. We will be informed by the detailed submissions of the regulated entities, and may have comments on those submissions in reply.

5 **CONCLUSIONS**

5.1 ***Action Plan***

5.1.1 Based on our submissions above, we propose that the Action Plan for the Board be in three steps:

(a) For those issues, such as deferral and variance accounts, and opening rate base, for which an early policy decision is both necessary and possible given the available evidence, it is submitted that the Board's Report in this consultation should establish such a policy, subject to section 5.2 below.

(b) For those issues in respect of which further information is required before the Board can make a policy decision, such as overhead capitalization and pension and future benefit costs, it is submitted that the Board should establish processes for gathering and analyzing that information in a timely way. Once the information and analysis is available, and there has been the appropriate public review, additional policies in respect of those issues should be established by the Board as available. It is not apparent to us that all outstanding issues should be dealt with in the same way. While it may be efficient for the Board to have a single generic proceeding to deal with all of them, we think that is unlikely to be the best approach. For example, we have noted earlier that, on the question of asset impairment, the best way to develop a body of data on which policy generalizations can be made may well be to hear some specific cases first (a sort of common law approach). Conversely, as we have also noted earlier we think that a case by case approach for pension and future benefits may be highly inefficient.

(c) In parallel with the first two steps, we believe that the Board should, in its Report arising out of this consultation, establish a policy framework that is conceptually consistent with the decision tree proposal we have outlined in these submissions, and practically consistent with the evaluation framework proposed by John Browne on behalf of eight ratepayer groups.

5.2 ***Evolution of Board Accounting Treatment***

5.2.1 In our submission, the Board cannot treat this process as a one-time event, after which this subject will be dealt with. Financial accounting is in a state of flux, and whether we like it or not regulatory accounting will be affected over at least the next five years (i.e. until the U.S. converts in 2014) or so in material ways. It is in the interests of the Board, the utilities and their customers that a predictable and disciplined approach to handling these issues as they arise be established and maintained.

5.2.2 To this end it is submitted that the method the Board uses to deal with these issues as they arise should achieve, at a minimum, two key objectives:

(a) ***Notice.*** When an accounting issue of general application is raised in a utility specific application, all parties that may have an interest in the issue should receive notice of its consideration, and an opportunity to participate.

(b) ***Consistency***. Decisions of Board panels on individual utility applications should, where they consider changes to accounting practices, be consistent with each other.

5.2.3 There are many ways for the Board to achieve these goals, and we believe that the Board can establish any number of processes to do so. We invite the Board to consider an approach that it has not generally used in the past, but that may be particularly suitable to this issue.

5.2.4 We suggest that the Board establish a standing Board panel to deal with accounting issues. The same Board members would sit on that panel for a given period (12-24 months, perhaps), and thus would have continuity of decision making and continuity of specialized knowledge**.** If an application before the Board includes a change in accounting treatment that potentially has applicability beyond the instant utility, the applicant should be required to flag that issue early in the process, and the hearing panel should – except where they determine it is inappropriate – divert consideration of that issue to the accounting panel. The accounting panel could then determine the best way to handle it, in light of other cases it is considering, and the evidence already available to it, with the accounting panel's decision then being adopted by the hearing panel for the purposes of determining that issue within the rate case.

5.2.5 Whether the Board adopts this suggestion, or a variation of it, or opts for a different approach, in our submission it is important that in this period of rapid change in the financial accounting rules, the objectives of notice and consistency should be important considerations informing the Board's process.

6 **OTHER MATTERS**

6.1 ***Process and Participation***

6.1.1 We thank the Board for inviting us to participate in this process. We hope these submissions are useful, and we would appreciate the opportunity to continue to be actively involved in all future consideration by the Board of issues relating to the transition to IFRS**.**

6.2 ***Costs***

6.2.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this process. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible, including in particular taking the lead, jointly with CME, in bringing together eight ratepayer groups to retain expert assistance jointly, thus reducing costs and, hopefully, increasing the effectiveness of ratepayer participation.

All of which is respectfully submitted.

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