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

REPLY COMMENTS OF ONTARIO POWER GENERATION INC.

DATED June 3, 2009

Introduction

OPG supports a flexible approach to the transition to IFRS. This approach was reflected in our earlier comments on asset retirement obligations, payments in lieu of corporate income taxes and pensions and employee future benefits costs.

The submissions filed with the OEB on May 25, 2009 highlight a fundamental divergence between the principles and processes advocated by distribution utilities and ratepayer groups. One important difference is the call by some ratepayer groups for an additional generic policy development process. OPG, for the reasons set out later in these comments, does not believe that this is necessary or appropriate.

Below, OPG has provided some comments on principles, process and filing requirements for the Board's consideration in establishing generic regulatory accounting requirements for distribution utilities. OPG notes that the PWU supported its request to deal with OPG's IFRS transition in its next case, stating that the current consultation has focused exclusively on distributors and that OPG's business is distinctive.

Competing Perspectives:

The consultation process has made it crystal clear that ratepayer groups and utilities have a different principled approach to the development of regulatory accounting policy. This fundamental difference is reflected in the policy development approach proposed to the OEB by these groups.

Ratepayer groups argue that the current regulatory methodology should continue as the default methodology until a utility can demonstrate that moving to IFRS is better. They contend more information and analysis of the financial impact of specific issues is required before the Board can appropriately consider whether a change from current regulatory accounting requirements is warranted.

Board Staff, the distribution utilities and related associations (EDA, PWU) support the use of IFRS as a basis for regulatory accounting, modified by exception. A host of reasons are provided for this approach, from minimizing compliance costs, to the impracticality of maintaining a system based on financial accounting requirements no longer supported by accounting bodies. The exceptions noted reflect utility specific circumstances or issues where IFRS does not appear to be the most appropriate basis to support regulatory accounting principles. In the latter situation, utilities are trying to work within IFRS provisions to minimize and/or eliminate financial impacts.

One ratepayer group, SEC, does acknowledge that it is likely inevitable that the current regulatory accounting system based on Canadian Generally Accepted Accounting Principles (CGAAP) with modifications will be replaced by a regulatory accounting system based on IFRS with modifications. SEC states that this "must be assumed to be the end state to which the current actions of the Board are directed." SEC's submission seeks "to distinguish between things the Board should determine today and things that should be determined after further evidence and analysis."

The Coalition of Large Distributors (CLD) submits that the global movement to IFRS recognizes the economic reality of underlying transactions and may be considered a refinement of existing financial reporting. The Board's ratemaking policies are rooted in cost of service assessments and IFRS is becoming the global standard for the determination and external reporting of financial information and costs. Their conclusion that the OEB should move to the globally accepted IFRS for reporting the economic reality of underlying transactions is intuitively reasonable.

Hydro One notes that the OEB's Accounting Procedures Handbook (APH) contains many references to CGAAP and there are few treatments in the APH that differ from CGAAP. While CGAAP was not designed to meet regulatory requirements, it has been able to do so with some overriding regulatory treatments and some additional interpretation. OPG agrees with Hydro One that "there is no reason to believe IFRS cannot also be used as the basis for ratemaking, with regulatory adjustments as required."

Union Gas concludes that "adjustments from current Canadian GAAP are limited. Consistent with this current approach and with the elimination of CGAAP, regulatory accounting should be aligned with IFRS as much as possible to provide the greatest clarity and understanding and minimize ongoing administrative burden associated with regulatory filing and reporting. Other accounting changes have, in the past, been recovered from ratepayers and this should continue, with mitigation used as required." This seems like a reasonable approach to OPG.

If IFRS is inevitable, then the question becomes: what modifications are necessary to enable IFRS based regulatory accounting requirements to adequately support the Board's ratemaking objectives? It is important to note that in most (but not all) instances, the movement to IFRS will not affect the underlying costs of providing utility service, rather it will simply impact the timing of when these costs are recognized for financial reporting purposes. In most cases the costs themselves are the same costs currently examined by the OEB in establishing just and reasonable rates. Deferral and variance accounts and other regulatory mechanisms can be used to adjust the timing with which costs are reflected in rates. Consideration of intergenerational equity issues related to the financial impact of adopting IFRS for specific issues is a matter that the OEB can address in setting the recovery period for establishing regulatory assets/liabilities related to the adoption of IFRS. It isn't a reason to delay implementation of an IFRS based regulatory accounting system.

PWU noted that the SEC agreed that both IFRS and the status quo could result in just and reasonable rates, and noted that vastly different utility circumstances may result in very different financial impacts to customers. Therefore, additional detail on financial impacts would not necessarily be helpful in determining whether IFRS supports the determination of just and reasonable rates.

Ratepayer groups have suggested that the Board needs to consider the state of issues that are currently under debate by the International Accounting Standards Board (IASB). OPG observes that, as new standards are issued in the future, they will either bring current IFRS more in line with regulatory requirements established by the Board (for example, if the IASB approves the use of regulatory assets and liabilities), or new differences will result. The Board will determine whether regulatory accounting requirements will reflect the revised IFRS requirements or whether the difference should be perpetuated as it has done in the past as CGAAP evolved. This is nothing new and certainly not a reason to defer the implementation of an IFRS based regulatory accounting system.

<u>Principles:</u>

OPG supports Enbridge's proposal to use the following three principles when developing the regulatory accounting requirements for distribution utilities:

- Any OEB rule or policy addressing the transition to IFRS should be flexible enough to accommodate different utilities and changing circumstances,
- The adoption of IFRS should not impose or result in negative financial implications on regulated entities,
- The considerations of the financial implications of the adoption of IFRS may require additional, specific examinations as part of a future proceeding (the

OEB should consider impacts of adoption of IFRS as part of individual utility applications to ensure there are no unintended consequences on utilities with different factual circumstances).

A number of ratepayer groups argue that the OEB should ensure that changes in financial accounting practices do not result in changes to rates. IGUA qualified its support for this principle, noting that there may be instances where adopting regulatory accounting with IFRS would best serve ratepayers by minimizing administrative and/or overall regulatory costs, minimizing regulatory complexity, and/or minimizing opacity of regulatory reporting versus audited public financial reporting under IFRS, and rate impacts may result.

OPG observes that changes in financial accounting often impact the timing of recognition of costs and income of a period. Since regulatory accounting is substantially rooted in financial accounting, the use of IFRS for regulatory accounting would change the timing costs are reflected in the revenue requirement of a utility. There are two ways to address the impact on rates. The method is generally advocated by ratepayers is to allow for differences between regulatory accounting and IFRS which, as advocated by some ratepayers, would result in maintaining the status quo. The end result is that there is no impact on rates resulting from the change to IFRS. This method is preferred in situations where financial accounting requirements do not support the setting of just and reasonable rates. The administrative burden associated with tracking and reporting is greater; however the OEB needs information that will enable it to establish just and reasonable rates; therefore modifications to financial accounting are the only option that provides sufficient appropriate information to support the setting of just and reasonable rates. The other method proposed by utilities is to offset the change in timing costs are recognized in rates using a deferral account or other similar regulatory approaches. Under this approach, the assessment of customer impacts is not a consideration in determining regulatory accounting requirements; it is addressed in the subsequent rate design process that will occur in utility-specific rate applications. The second method would effectively be precluded if the principle required the Board to ensure that changes to financial accounting do not result in changes to rates in setting regulatory accounting requirements, which OPG submits is not reasonable.

Some ratepayer groups submit that a no harm standard should be applied for both utilities and ratepayers as a principle guiding the OEB's determination of its regulatory accounting requirements. OPG observes that this is a very onerous standard to apply in practice. The principle proposed by Board Staff supports "balancing the effects on both customers and shareholders." Regulatory principles are typically less prescriptive, such as the principle that discrimination reflected in rates should not be "undue." Accordingly, OPG does not believe that a no harm standard should be applied.

A number of intervenors seem to suggest that moving to IFRS will mean that an external body is setting regulatory standards. This has not been the case in the past and there is no reason to expect this will be the case in the future. The OEB is not abdicating its authority by using a more evolved financial accounting system as the basis for setting its regulatory accounting requirements. The OEB is applying its authority in an efficient manner. There has been no suggestion by any party that the OEB should adopt regulatory accounting requirements that are not supportive of the OEB requirement to set just and reasonable rates. OPG sees no reason for concern that the Board will abdicate rather than apply its authority, and has seen no evidence that the OEB has done anything but apply its authority in setting regulatory accounting requirements.

Some ratepayer groups submit that, as a matter of principle, the OEB needs to require a consideration of the impact on all regulated utilities and their financial viability prior to determining regulatory accounting requirements for a specific issue. They want the method of determining regulatory accounting requirements to be systematic and enduring. The implication is that any change in IFRS requirements must be addressed on a generic basis. Such an approach effectively precludes the assessment of issues in a utility-specific rate application. The OEB has a long history of addressing issues in utility-specific proceedings, and applying them to other regulated entities in subsequent utility proceedings if the circumstances of these utilities warrant similar treatment. From time to time, precedent derived in utility-specific proceedings becomes codified in the regulatory accounting requirements. The OEB has applied this method of regulation effectively for decades, and should not be precluded from continuing this approach. This additional principle advocated by ratepayer groups is not required.

Utilities support the principle of standardization/uniformity in general; provided the regulatory accounting system is sufficiently flexible to reflect different utility circumstances. Ratepayers have advocated changes to operationalize the application of their concept of flexibility. CCC states that the standard regulatory treatment should apply to all utilities unless justified by differing circumstances. SEC states that the principles “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.” These modifications fly in the face of the concept of flexibility and should not be accepted.

Processes:

Distribution utilities are intimately familiar with the differences between current Canadian GAAP and the OEB’s current regulatory accounting requirements. These utilities have a practical understanding of the issues associated with addressing these differences. OPG notes that the vast majority of these distributors have encouraged the Board to establish its regulatory accounting requirements expeditiously in order to provide the time required to enable these utilities to comply with the Board's information requirements in a timely fashion. While this is not an issue for OPG, distribution utilities have been upfront from Day 1 about the urgency of this process to make informed system investments. OPG submits that additional review processes for distribution utilities should be avoided to the greatest extent possible.

The greater the divergence between financial and regulatory accounting requirements, the greater will be the cost and complexity of the systems and processes necessary to support these differences. Utilities both recognize and appreciate that the current IFRS will not be the final word for regulatory accounting purposes. Indeed they support modifications to IFRS on a number of issues.

The distribution utilities support what OPG considers to be a pragmatic approach. It effectively advocates the status quo—the regulatory accounting system should be based on the financial accounting system with modifications to address deficiencies in the financial accounting system which do not support rate setting. Current rates reflect current concepts of costs, while future rates will reflect a more evolved definition of costs more closely based on economic reality. There will be a difference in cost-based rates as a result of differences in the recognition of costs. Rate applications are the appropriate process to address the financial impact on utilities and ratepayers.

Enbridge suggests the Board prepare a preliminary report on the extent and manner that the OEB intends to adopt IFRS. Discussion of financial impacts on a utility-specific basis should occur in utility-specific rate applications, where utility-specific ratemaking, capital structure and financial risk profile issues can be addressed. OPG is of the view that where the OEB does not believe it has a sufficient level of information to finalize a decision on a specific issue, Enbridge's submission makes sense. However, it is not necessary for the OEB to characterize its position on all issues as preliminary if the OEB is satisfied it has sufficient information to make a final decision on an issue.

The SEC proposes a new structure for dealing with accounting changes. This would involve a standing panel of the Board or other such approach developed by the Board designed to notify interested parties of accounting issues that may have general application and promote consistency of decisions on accounting changes between hearing panels.

The SEC criticizes the Board's past approach for setting regulatory accounting policy, concluding that a generic review would have been preferable. This approach follows from the view advocated by SEC that the method of determining the regulatory accounting requirements resulting from IFRS should be enduring. OPG submits that this principle should not be adopted by the OEB as discussed in the previous section; therefore it follows that a process designed to enshrine this principle is unnecessary for the same reasons.

<u>Issue Specific Submissions:</u>

1) Asset Retirement Obligations (AROs) (Issue 3.4):

OPG notes that both the CCC and SEC agree that OPG is a special case in respect of AROs. CCC states that "the magnitude of OPG's ARO and the complexity of the financial arrangements and government obligations distinguish OPG from other Board-regulated entities with negative salvage or ARO." The SEC states that "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." OPG reiterates its initial submission that the Board specifically exempt it from the requirements in the electricity distribution utility regulatory accounting requirements relating to ARO.

OPG notes that Enbridge and Union are advocating maintaining the status quo, albeit based on different utility specific circumstances. Union's status quo recognizes non-legal and non-constructive obligations as AROs, collects these amounts from ratepayers and establishes a liability to record the funds collected to meet these AROs. Enbridge's expenses will increase to reflect the collection of constructive obligations which will increase the size of its accounting AROs, not the regulatory accounting treatment per se. If the OEB is inclined to develop regulatory accounting standards at this time, the accounting requirements should recognize both approaches as supportive of just and reasonable rates, just like they have been in the past.

OPG's notes that VECC supports the Board Staff proposal to report depreciation and accretion separately as VECC believes these costs are unique in nature and notes that a different revenue requirement treatment may be required. Similarly, Toronto Hydro states that that the financial impact of adopting IFRS for AROs needs to be reviewed separately as there will be incremental costs to be recovered in revenue requirement. Toronto Hydro suggests that the Board should determine how it will review these costs (mechanism and frequency) and assess the timing of rate recovery. With respect to method and timing, CCC submits that the ratemaking treatment for asset retirement obligations should be decided on a case-by-case basis. CCC notes that the OEB has yet to establish a regulatory accounting principle with respect to negative salvage, with the exception of OPG. CCC did not feel there was sufficient information to evaluate ratemaking principles and opine on a generic ratemaking treatment. OPG is of the view that CCC has provided the correct advice for the Board to follow in this regard.

Even the SEC's lone support for a generic review of the ARO issue is highly qualified. It noted that "many complex intergenerational considerations are "potentially applicable" to other regulated utilities, and that a generic review "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." The submissions of Union and Enbridge, and informal conversations with other utilities have left OPG with the impression that the AROs of various electric distribution utilities may be quite different, and indeed are different between gas and electric distributors. To be sure, these AROs are much different than the AROs of OPG.

Everything OPG has heard in this proceeding is supportive of a case-by-case approach to AROs. The regulatory accounting system will need to be sufficiently flexible to reflect the rate-making approach determined to be reasonable by the Board panel considering the utility-specific circumstances.

2) Pension and Employee Future Benefit Costs (Issue 5.1):

With the exception of the SEC, all parties either supported or did not comment on Board Staff's proposal. Hydro One supports the use of IFRS for pensions since it would be easier; however they noted that they could accommodate Board Staff's proposal.

Union Gas is one utility that has defined benefit plans to provide employee future benefits. Union's presentation during the technical conference on May 5, 2009 outlined its proposal to write-off unamortized actuarial losses, unamortized past service costs and the unamortized transitional obligation through retained earnings on transition to IFRS. It noted that this treatment would reduce future expenses, as the recognition of these expenses would no longer be deferred. Nothing has changed that would affect the recoverability of these costs. The only thing that is changing is the timing of when these recoverable expenses are recognized in the financial statements. OPG observes that if these expenses were recorded as a regulatory asset (liability), and amortized into rates over the period they are currently recognized under Canadian GAAP (i.e. the average employee remaining service life or AERSL); there would be no rate impact. The impact would be in form not in substance (i.e. IFRS expense plus amortization of the regulatory asset or liability rather than the current CGAAP expense). Absent IFRS, these gains or losses would be included in pension expense in subsequent periods, and would therefore be recovered from ratepayers. OPG notes that no submissions identified a concern with Union's proposed amendment.

OPG submits that the regulatory accounting system should be sufficiently flexible to "provide for the recovery of a regulatory asset or liability account for distribution utilities with defined benefit plans." Toronto Hydro's submission similarly supports the use of a regulatory asset or liability if a utility elects to charge gains/losses to retained earnings. OPG believes that the OEB should acknowledge this as an acceptable approach in its regulatory accounting requirements. This amendment will support the Board's Staff's widely accepted proposal "to review pensions and employee future benefit costs in the respective gas utility applications."

OPG notes that the SEC is the lone party that considers this issue complex, "potentially requiring expert actuarial and accounting evidence to get at the root of the policy issues and impacts at play." SEC notes that the IASB is currently considering whether to continue certain provisions that effectively limit the volatility of pension costs. The OEB could easily establish regulatory assets or liabilities to address the issue of volatility, either on an issue specific basis or on a comprehensive basis. There is no basis for the concern expressed by SEC, and no justification for a generic review process involving accounting and actuarial experts.

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

All submissions support Board Staff's ratemaking approach. While Hydro One supported the use of IFRS as it would be easier, it noted that they could accommodate the Board Staff proposals

EDA notes that some IFRS implementation issues might impact the calculation of the income tax provision, and submits that these impacts need to be addressed through the approval of a regulatory asset or liability account. The submissions of PWU and Toronto Hydro support EDA's qualified acceptance of Board Staff's position. OPG submits that the amendment proposed by the EDA is reasonable. Enbridge advocates the establishment of a future income tax deferral account, noting this "will not likely require a revenue requirement impact".

Union notes it currently has regulatory assets/liabilities established on the basis that these costs will be recoverable in the future. Union explained that the regulatory asset or liability account balance would automatically reverse itself in the future when the current taxes become larger than future income taxes. Union expects these costs will be recoverable in the future and requested the OEB to confirm this expectation as part of its policy on the conversion to IFRS. OPG supports these submissions and further submits that the policy should provide the opportunity for distribution utilities to apply to the OEB for an assessment of the recoverability of future income tax amounts that the utility is required to recognize in financial accounting income as a result of IFRS.

VECC and the SEC do not disagree with these proposals; however they argue for amendments. VECC submits that it would be inappropriate for the Board to provide full assurance that any deferral/variance account balances are recoverable without some form of review of reasonableness and prudence. Similarly, the SEC submits that any written policy on deferral and variance accounts should be the result of a consultative process subsequent to the IASB review of this matter. SEC observes that the Green Energy Act may make the tax positions of some companies more complicated, and therefore supports a generic review of the recoverability of tax obligations from ratepayers. The issue of whether a deferral account for deferred taxes is appropriate and, if so, on what basis and with what rules could be included in that generic review. SEC suggests that such a review could occur next year.

OPG notes that it intends to address this issue in its payment amount application, and trusts that any generic review of this issue for distribution utilities will not impair the assessment of reasonableness, prudence and recoverability of future income tax amounts for OPG.

4) Distributor Filing Requirements (Issue 9)

OPG expects to file a payment application for the 2011 to 2012 period. OPG notes that some utilities are using 2011 as a measurement period (e.g. Hydro One is filing a 2010 to 2011 forecast test period, using 2011 as the basis for determining the impact of IFRS), while others are proposing to use 2010 as a measurement period (e.g. Union proposes to use 2010 to measure the financial impact of adopting IFRS, noting that its IFRS implementation plan does not reflect continuing CGAAP beyond 2010).

VECC suggests that some flexibility may be required as regards to 2011 rebasing applications. VECC suggests that these utilities will have a strong incentive to file on a modified IFRS basis, as it will align rates more closely with financial reporting standards. However an August 2010 filing may mean that IFRS based estimates are not defined which may require the use of current GAAP based forecasts. VECC concludes that this may require updates to the 2011 filing or filing based on current practice for 2011.

CCC supports VECC's position, submitting that the Board will need to consider the filing and reporting requirements of each utility on a case-by-case basis, depending on the timing of the utility's next test year, given that the test periods for utilities cover a spectrum of time. Similarly, Enbridge suggests the Board leave the timing of when rate impact information should be considered by the Board open to reflect specific utility rate making circumstances. OPG supports these submissions.