



June 3, 2009

Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street 27<sup>th</sup> Floor  
Toronto, ON  
M4P 1E4  
Attention: Ms. Kirsten Walli, Board Secretary

**Re: EB-2008-0408 Consultation on Transition to International Financial Reporting  
Standards and Consequent Amendments to Regulatory Instruments  
Reply to Submissions filed with the Ontario Energy Board, May 25<sup>th</sup>, 2009**

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The Coalition of Large Distributors (“CLD”) comprises Enersource Hydro Mississauga, Horizon Utilities, Hydro Ottawa, PowerStream, Toronto Hydro-Electric System Limited, and Veridian Connections. The CLD provided a written submission on the Ontario Energy Board Staff (“Board” and “Board staff”, respectively) Proposal for the Transition to International Financial Reporting Standards (“IFRS”). The CLD has reviewed the submissions from the fifteen other stakeholders and as a result wishes to make the following reply submission.

The CLD’s original submission explained that we generally support the Board staff’s Proposal which would result in a modified IFRS for regulatory accounting purposes. Upon reading the rest of the submissions, it appears clear that all parties are in agreement that the end state of regulatory accounting for Ontario utilities will be some modified form of IFRS. For example, the School Energy Coalition (“SEC”), which holds the most divergent views on Board staff’s Proposals from the CLD, states *“One question implicit in this consultation...is whether the current regulatory account system...should be replaced with a new regulatory accounting system that is, at its root, IFRS with modifications. Our answer is that this is likely inevitable and at some point must be assumed to be the end state to which the current actions of the Board are directed.”*<sup>1</sup>

Where the parties such as ‘Group of 8’ differ from the view of the electricity distributors, is on how we will arrive at that end point. These groups would like to arrive at the modified IFRS using the status quo of a modified CGAAP, as the starting point. However, as the Consumers Council of Canada (“CCC”) stated *“Whether starting from regulatory principles or relying upon IFRS as the default, it is possible to end up with the same conclusion.”*<sup>2</sup>

How we arrive at modified IFRS also has an impact on when the Board is able to make decisions on what utilities should be doing for regulatory accounting. If, as Board staff proposes, we start with IFRS as the default, then the Board is able to make a timely decision without waiting for further information. However, if we start with the status quo and decide not to make a decision

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<sup>1</sup> SEC Submission, Section 1.2.2, pg. 3

<sup>2</sup> CCC Submission, pg. 5

until we have sufficient information to apply an ‘Evaluation Framework’ or apply SEC’s ‘decision making tool’, then the Board would have to delay their decisions well into 2010.

The CLD notes that there are a number of issues upon which none of the submissions disagree and therefore the Board could make a decision immediately, based on Board staff’s Proposals. These include:

- The continued use of deferral and variance accounts.
- The use of Net Book Value for opening rate base.
- The use of Historical Acquisition Cost of ongoing additions to rate base.
- The inclusion of intangible assets in rate base.
- The treatment of asset impairment.
- The treatment of inventory valuation.
- The treatment of PILs (with the Electricity Distributors’ Association’s proposal).
- Not waiting for decisions by the accounting standard setting bodies.

There are a number of issues for which there is almost total agreement and for which the Board could make a decision in the near future, based on Board staff’s Proposals:

- Use of actual borrowing costs for construction work in progress.
- The treatment of customer contributions subject to satisfactory resolution to the issue of the revenue requirement and rate making implications.
- Asset Retirement Obligations.
- Gains and losses.
- Treatment of pensions and employee future benefits.
- Requirement for an audit of regulatory books.

The two main issues for which there are divergent opinions on whether the Board should make a decision now are:

- Capitalization
- Depreciation

SEC says “*no credible case for urgency has been made sufficient to overturn the need for thoughtful policy decisions based on solid evidence.*”<sup>3</sup> The CLD submits that the urgency arises from the Canadian Accounting Standards Board deadline of January 1, 2011 when all publicly accountable enterprises (which means most, if not all, distributors) will adopt IFRS as the source of generally accepted accounting principles. In addition, distributors must prepare financials using IFRS for 2010 while still reporting in CGAPP. In order to do this, distributors must have in place by January 1, 2010:

- Requirements for capitalization for IFRS.
- Requirements for depreciation under IFRS.
- The systems in place to handle two sets of ledgers at the transaction level.
- The additional resources in place.
- The processes in place.

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<sup>3</sup> SEC Submission, Section 1.2.6(d), pg. 4

This work is amplified if a distributor is preparing a cost of service (“CoS”) application for 2011. A distributor would start preparation for a 2011 CoS application early in 2010 and at that time needs to know the rules for preparing forecasts for operating expenses and rate base.

Distributors are currently in the process of establishing strategic plans and budgets for 2010 and subsequent years. Without knowing the extent to which actual revenues (based on regulatory accounting) will produce the necessary cash flow from operations to invest in the distribution systems, it is extremely difficult to plan. Furthermore, delays create uncertainty that a distributor’s actual net income will be consistent with the regulated return to allow a reasonable return for shareholders. This could directly affect our investment decisions in 2011.

SEC suggests that it is electricity distributors’ inexperience that makes them impatient<sup>4</sup>. However, no utility has experience in completely changing the fundamental basis of their financial systems. In addition, we are approaching unprecedented times in the life of electricity distributors. The transition to IFRS by electricity distributors in 2011 is an extremely significant event, on the par with amalgamation and market opening. Layered on top of this fundamental change are further changes related to the Green Energy Act, including increased Conservation and Demand Management programs, connecting and settling with Embedded Generation, developing a Smart Grid, plus the CIS system implications of the Low Income Consultations. All of these activities affect the future investment plans of distributors. Having uncertainty related to IFRS could impact investment decision making.

As Hydro One said in their submission “*there is a pressing need for the Board to pronounce on the issues and principles covered by the Staff Proposal by the end of 2009.*”<sup>5</sup> And as the EDA said “*Any delay in the Board’s decision will cause undue strain to LDCs in implementing IFRS...it is imperative that the Board’s direction is made available to LDCs at the earliest possible date.*”<sup>6</sup>

The CLD urges the Board to adopt the Board staff’s Proposals with respect to capitalization and depreciation with the recognition that IFRS will continue to evolve and as a result the Board will be required to revisit its decisions on an ongoing basis. This is how the modified CGAAP became the accepted regulatory accounting in the past.

In SEC’s submission, they state that if IFRS is imposed without the application of ratemaking principles then it would result in rates that are not just and reasonable.<sup>7</sup> IFRS will form the fundamental financial basis of a utility’s costs, and rates are designed to recover a utility’s prudently incurred costs. What is just and reasonable in a given case can occupy a range of outcomes. It would be wrong to assert that the IFRS result is necessarily out of that range. It is reasonable to assume that costs under IFRS will be in this range as they are established based on international accounting principles that require greater scrutiny and analysis.

CCC states that “*A financial reporting standard, such as IFRS, should never be a default for regulatory accounting principles as the objectives of rate making and financial reporting*

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<sup>4</sup> SEC submission, Section 4.1.4, pg. 18

<sup>5</sup> Hydro One submission, pg. 3

<sup>6</sup> EDA submission, pg. 4

<sup>7</sup> SEC submission, Section 4.8.2, pg. 32

*are different. If there needs to be any default, it should be the status quo – the operative set of regulatory principles.”*<sup>8</sup> The CLD submits that the status quo is not the existing modified CGAPP but a regulatory accounting system based on the current financial accounting system with modifications to address deficiencies which do not support rate setting and which continue to evolve. This does not mean that the Board abdicates its responsibility for regulatory accounting to financial accounting but uses it as a starting point.

Both CCC and the Vulnerable Energy Consumer’s Coalition suggested that the Board should establish a Board staff-led industry working group to work through the issues related to identifying the differences between an IRM year revenue requirement and an IFRS modified revenue requirement. The CLD also supports this proposal and notes that the work should be conducted with the objective of producing results that can be incorporated in distributors’ 2011 IRM applications.

Thank you for this opportunity to provide a reply to the May 25<sup>th</sup>, 2009 submissions on the Board staff’s Proposal for the Transition to IFRS. The CLD is appreciative of the Board’s willingness to have an open and complete discussion on the issues, however the time has come to provide distributors with the required certainty. Two paper copies, along with an electronic version accompany this submission.

Yours truly,

*Original Signed By*

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(On behalf of the Coalition of Large Distributors)

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<sup>8</sup> CCC Submission, pg. 5