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Ontario

By E-Mail Only

November 12, 2007

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Hydro Ottawa Limited's Application to Approve an Accounting Order to Establish a Variance Account - Board File No. EB-2007-0663

In accordance with the Notice of Application and Hearing / Procedural Order No. 1, issued on October 30, 2007, please find enclosed interrogatories prepared by Ontario Energy Board technical staff on the evidence submitted by Hydro Ottawa Limited in its application.

Yours truly,

Original signed by

Lee Harmer
Manager, Electricity Rate Applications

Enclosures

cc: Applicant and Counsel
Intervenors of Record

Board Staff Interrogatories
2007 Electricity Distribution Rates
Variance Account for Capitalized Overhead
Hydro Ottawa Limited
EB-2007-0770

1 2007 CAPITALIZED OVERHEAD VARIANCE ACCOUNT

Issue 1.1 Is the variance account request by Hydro Ottawa reasonable?

1.1 Ref: Exhibit(s) Letter September 14, 2007 – Application

Hydro Ottawa was to have implemented the new allocation procedure and updated capitalization policy on October 1, 2007.

a) Please confirm that Hydro Ottawa has implemented the new allocation procedure and updated capitalization policy on October 1, 2007. If Hydro Ottawa has not implemented these please explain why not.

b) Hydro Ottawa estimates in the application that the resultant impact will be approximately $1.5 to $2.0 million. Please advise if this estimate is an annualized amount or for the last calendar quarter of 2007. Please advise if Hydro Ottawa still believes that this will be the approximate amount. If the estimate has changed please provide the new estimate.

c) Please confirm if Hydro Ottawa has closed the company's financial records for the month ended October 2007. If Hydro Ottawa has closed the records please confirm if Hydro Ottawa has recorded the affected overhead costs using the new accounting procedure. In the alternative, please explain why it has not used the new procedure.

d) Please prepare a detailed step-by-step calculation, including details on assumptions made, of the amount Hydro Ottawa would propose to book to the requested variance for the month of October 2007. Include in the detail the accounting entries for the proposed transaction.

1.2 Ref: Exhibit(s) Letter September 14, 2007 – Application

Hydro Ottawa had its 2007 electricity distribution rates set in accordance with the 2^{nd} Generation Incentive Regulation Mechanism "price cap" as documented with the Report of the Board on Cost of Capital and 2^{nd} Generation Incentive Regulation Mechanism for Ontario Electricity Distributors (the "Board Report"). Hydro Ottawa has applied for an accounting order establishing a variance account request to track incremental costs resulting from a change in allocation procedure for capital costs for the remainder of the calendar year.

In section 4.2.4 of the Board Report, the Board stated the following with respect to the need for and treatment of deferral and variance accounts under 2^{nd} Generation IRM:

> "Deferral and variance account balances will be dealt with in accordance with the provisions of the *Ontario Energy Board Act, 1998*.
>
> Consistent with its proposal on Z-factors, the Board has determined that, to the extent possible, it will limit reliance on creation of new deferral accounts during the term of the scheme to well-defined and well-justified cases only. Z-factor rules should govern need for, and treatment of deferral accounts."

Under section 3.5 – Z-factors, the Board Report contains the following:

> **"For 2^{nd} Generation IRM, the Board will limit reliance on Z-factors to well-defined and well-justified cases only – specifically, Z-factors will be limited to changes in tax rules and to natural disasters**. The Board believes that for 2^{nd} Generation IRM, Z-factors should be limited to events genuinely external to the regulatory regime and beyond the control of management and the Board – changes in Board policy should not be included. The Board can always assess the implications of such changes and make provision for them. Regardless, in order for amounts to be considered for recovery in a **Z-factor**, the **amounts must satisfy the eligibility criteria set out in Table 3**, below. The Board notes that changes in tax rules may result in positive or negative amounts.

Table 3: Z-Factor Amount Eligibility Criteria

Criteria	Description
Causation	Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.
Materiality	The amounts must have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.
Prudence	The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

> In addition, **the Board intends to maintain the materiality thresholds established in the 2006 EDR Handbook**: for expenses, the materiality threshold would be 0.2% of total distribution expenses before taxes; and for capital cost recovery, the materiality threshold would be 0.2% of net fixed assets. In both cases, the materiality threshold must be met on an individual event basis in order to be eligible for potential recovery."

The section concludes:

> "Therefore, the Board will expect that any application for a Z-factor will be accompanied by a clear demonstration that the management of the distributor could not have been able to plan and budget for the event."

Please document how the request for the deferral account satisfies the conditions under sections 4.2.4 and 3.5 of the Board Report with respect to: causality, materiality, prudence, and exogeneity/inability of management to control.

1.3 Ref: Exhibit(s) Exhibit B1/Tab3/Sch1/Pg 1 Capitalization Policy and Allocation procedure

Hydro Ottawa stated the review of its capitalization policy and cost allocation procedure was triggered by the Rate-Regulated Operations Exposure Draft, which was released by the Canadian Institute of Chartered Accountants in March 2007.

a) The Canadian Accounting Standards Board issued its decision on this Exposure Draft on August 22, 2007. Please discuss how this decision is relevant and requires changes, if any, to Hydro Ottawa's capitalization policy and cost allocation procedure based on changes to current accounting standards.

b) Is the 2007 fiscal year impacted by any changes to current accounting standards arising from this decision?

1.4 Ref: Exhibit(s) Appendix U Report to Audit Committee August 21, 2007

On page 2 paragraph 4 the report states *"It is management's opinion that the adjustment to overhead allocations is a change in accounting estimate only. As suggested by our external auditors, Ernst & Young, an independent professional accounting firm will be sought to provide an opinion on this accounting change in accordance with section 1506 – Accounting Changes, of the Canadian Institute of Chartered Accountant's (CICA) accounting handbook*."

a) Please confirm whether the opinion noted above has been completed by the independent professional accounting firm.
   - i If yes, please provide a copy of that opinion.
   - ii If no, please confirm expected date of completion and explanation for delay. If the declared opinion were to be anything other than a change in accounting estimate, how would Hydro Ottawa request for a variance account change?

1.5 Ref: Exhibit(s) Appendix U Report to Audit Committee August 21, 2007

On page 5 paragraph 17 the report states "*Once a change in accounting estimate is considered and accepted it is a requirement of Generally Accepted Accounting Principles (GAAP) that it be implemented prospectively and in a timely manner. Consequently, implementation has been planned for October 1, 2007, as this is the most practical timeframe in which to incorporate the revised methodology into our existing accounting processes*."

a) Please provide reference and copy of the CICA handbook section that details the "requirement" to implement in a timely manner.

b) Please provide discussion by management on the subject of interpretation of the CICA handbook section detailing "requirement" to implement in a timely manner.

c) Has Hydro Ottawa received any documentation from the company's external auditor or other independent professional accounting firm that discusses the implementation timeframe for the change in accounting estimate and procedure? Please provide copy of all documentation.

d) Please discuss what the company's management believes the consequences would have been if the implementation of the change in accounting estimate were to have been January 1, 2008.

e) Does Hydro Ottawa's management believe that they had the ability to control the date of implementation? Please discuss.

f) Please provide a discussion by Hydro Ottawa's management on what reasons the company would have for not continuing with the current procedure?

g) Has Hydro Ottawa ever disclosed any other accounting changes in the company's annual audited financial statements? If yes, please provide a copy of the note(s) to the financial statements supporting the change and its date of implementation. Please explain the effective date for implementation of such change and in particular identify any which were mid-year changes.